2013 Year-End Securities Litigation and Enforcement Highlights

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By: Marc D. Powers, Mark A. Kornfeld, Brian W. Song,
Jonathan A. Forman, Susrut A. Carpenter,
Margaret E. Hirce, Marco Molina, Erica Sollie,
Joshua B. Rog and Christopher B. Gallagher

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We are pleased to share with you the 2013 Year-End Highlights Report from the BakerHostetler Securities Litigation and Regulatory Enforcement Practice Team, a periodic survey, in addition to our Executive Alerts, which focuses on matters we believe 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 also encourage you to contact any of the practice team members listed at the end of the Report.

This Report highlights recent significant developments in:

- ***Securities law cases***, including the U.S. Supreme Court's reconsideration of the "fraud on the market" theory in *Halliburton* and its review of a circuit split in interpreting the Securities Litigation Uniform Standards Act of 1998 in the consolidated *Troice* cases;

- ***Insider trading cases***, including criminal and civil cases related to the government investigations of SAC Capital Advisors, LP and Galleon Management, LP;

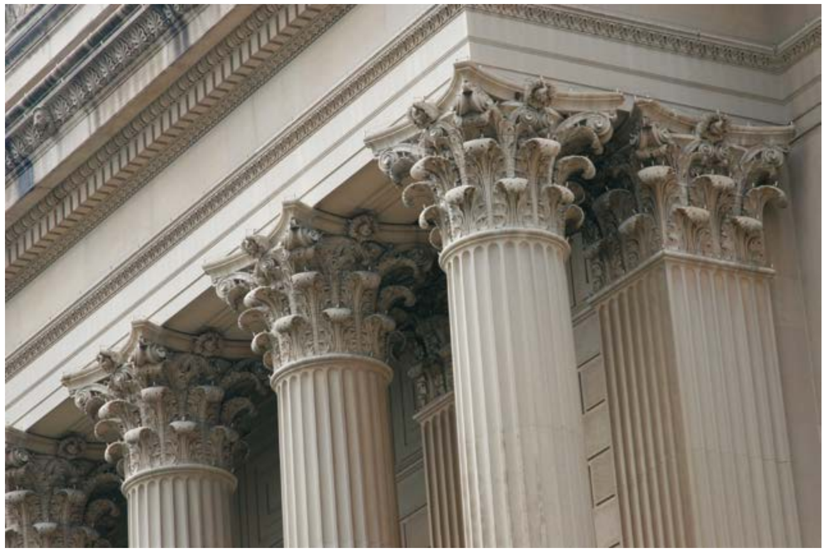
- ***Civil and regulatory settlements***, including settlements relating to mortgage backed securities, collateralized debt obligations and municipal bonds;

- ***Investment advisor and hedge fund cases***, including enforcement actions resulting from the Securities and Exchange Commission's ("SEC") Compliance Program Initiative;

- ***Commodities and futures regulation and cases***, including guidance on the cross-border application of U.S. derivatives rules and settlements relating to the first-ever "spoofing" case brought by the Commodity Futures Trading Commission, LIBOR manipulation cases and the case against MF Global for unlawful use of customer segregated funds;

- ***Securities regulation***, including the publication of the SEC's Market Information Data Analytics System and the clarification of Regulation SHO's requirements; and

- ***The SEC's Cooperation Program***, including the first ever deferred prosecution agreement with an individual and settlements reflecting how the SEC's newly adopted policy to require admissions under certain facts and circumstances may affect its Cooperation Program.



I. Supreme Court Cases

During the second half of 2013, the U.S. Supreme Court considered two cases with significant implications to securities litigation and invited the U.S. Solicitor General to file a brief in connection with considering whether to review a third case.

***Halliburton Co. v. Erica P. John Fund, Inc.*, No. 13-317**

On November 15, 2013, the Court granted a petition for writ of certiorari by Halliburton (as anticipated in our previous Executive Alert) to address two significant securities law issues (i) whether the Court should overturn or modify the "fraud on the market" presumption of reliance it created in *Basic Inc. v. Levinson,* 485 U.S. 224 (1988), and (ii) whether that presumption may be rebuttable at the class certification stage.

The fraud on the market doctrine is based on the efficient capital market hypothesis that security prices reflect all material information available to the public about each publicly traded company. Pursuant to this doctrine, reliance may be presumed in a securities class action because it is assumed that investors trade in securities based on the integrity of the market prices. If the Court were to overturn or modify the fraud on the market presumption, plaintiffs in securities fraud class actions would have the burden of showing class-wide reliance at the class certification stage.

In its petition, Halliburton argued that the Court should overrule *Basic* because its "central economic premise—the efficient capital markets hypothesis—has been almost universally repudiated" and, as a result, "federal courts have struggled to apply it, and state courts have refused to adopt it."[1] Halliburton also argued that *Basic* should be overturned because it is inconsistent with the Court's recent class-certification jurisprudence, which has increased plaintiffs' burden at the class certification stage to prove that common issues predominate. In the alternative, Halliburton argued that the Court should substantially modify the threshold for invoking a presumption of reliance by requiring plaintiffs seeking class certification "to prove that the alleged misrepresentations *actually* distorted the market price."

In response, Erica P. John Fund argued that the Court should preserve its decision in *Basic* because it is "the foundation for modern, private securities litigation" and has not been revisited or reconsidered by the Court or Congress since it was issued over twenty-five years ago.[2] The Fund also argued that Halliburton's alternative argument "flatly contradicts" the Court's holding in *Amgen* (which we discussed in our Mid-Year Report) "because it requires Plaintiff to prove that it will prevail as to reliance, not just that reliance will turn on common evidence."

Several amicus briefs were submitted by prominent business, governmental, legal and academic groups, including a brief on behalf of Former Members of Congress, Senior SEC Officials and Congressional Counsel (to note that Congress did not endorse the fraud-on-the-market doctrine in the Private Securities Litigation Reform Act of 1995)[3] and a brief on behalf of the U.S. Chamber of Commerce, the National Association of Manufacturers, the Pharmaceutical Research and Manufacturers of America and the Business Roundtable (to argue that *Basic* should be overruled because, among other things, it has generated

[1] Petition for a Writ of Certiorari, *Halliburton Co. v. Erica P. John Fund, Inc.* (Sept. 9, 2013), http://sblog.s3.amazonaws.com/wp-content/uploads/2013/10/No-13_Halliburton-Cert-Petition-Ok-to-Print.pdf.

[2] Brief in Opposition to Petition for a Writ of Certiorari, *Halliburton Co. v. Erica P. John Fund, Inc.* (Oct. 11, 2013), http://sblog.s3.amazonaws.com/wp-content/uploads/2013/10/No.-13-317-Brief-in-Opposition.pdf.

[3] Brief for Former Members of Congress, Senior SEC Officials and Congressional Counsel as Amici Curiae Supporting Neither Party, *Halliburton Co. v. Erica P. John Fund, Inc.* (Jan. 6, 2014), http://sblog.s3.amazonaws.com/wp-content/uploads/2014/01/13-317-ac-Former-Members-of-Congress-supporting-neither-party1.pdf.

excessive costs for businesses and hampered capital markets).[4]

The Court is scheduled to hear oral argument in this case on March 4, 2014.

***Chadbourne & Parke LLP v. Troice*, No. 12-79**

***Willis of Inc. v. Troice*, No. 12-86**

***Proskauer Rose LLP v. Troice*, No. 12-88**

On October 7, 2013, the Court heard oral argument in three consolidated cases involving the application of the Securities Litigation Uniform Standards Act of 1998 ("SLUSA"), which prohibits plaintiffs from bringing class actions in state or federal courts alleging fraud under state law "in connection with the purchase or sale" of "covered securities."

These three cases—all arising out of the Allen Stanford Ponzi scheme and on appeal from the U.S. Court of Appeals for the Fifth Circuit—highlight a split in how the circuit courts interpret the circumstances in which an alleged misrepresentation is sufficiently "material" to the purchase or sale of a "covered security" to satisfy SLUSA's "in connection with" requirement and, as a result, preclude a class action. In particular, the Fifth Circuit in these cases adopted the Ninth Circuit's standard in holding that the claims were not precluded and expressly rejecting conflicting standards used by the Second, Sixth and Eleventh Circuits, which would have precluded the claims pursuant to SLUSA. Given this, the Court granted cert in these cases to address the following issues:

- Whether SLUSA precludes a class action under state securities law alleging fraud and misrepresentations of securities as SLUSA-covered securities;[5]

[4] Brief for Chamber of Commerce of the United States of America, National Association of Manufacturers, Pharmaceutical Research and Manufacturers of America and Business Roundtable as Amici Curiae Supporting Petitioners, *Halliburton Co. v. Erica P. John Fund, Inc.* (Jan. 6, 2014), http://sblog.s3.amazonaws.com/wp-content/uploads/2014/01/U.S.-Chamber-Merits-Amicus-Brief-Halliburton-v.-Erica-P.-John-Fund-U.S.-Supreme-Court.pdf.

[5] Petition for Writ of Certiorari, *Chadbourne & Parke, LLP v. Troice* (July 18, 2012), http://sblog.s3.amazonaws.com/wp-content/uploads/2012/08/12-79-CHADBOURNE-CERT-PETITION.pdf.

- Whether a covered state law class action complaint that unquestionably alleges a misrepresentation “in connection with” the purchase or sale of a security covered by SLUSA nonetheless can escape its application by including other allegations that are farther removed from a covered securities transaction;[6] and

- Whether SLUSA prohibits private class actions based on state law only where the alleged purchase or sale of a covered security is “more than tangentially related” to the “heart, crux or gravamen” of the alleged fraud.[7]

The three petitions and supporting briefs shared the same, general arguments. Among other things, they each argued that SLUSA was triggered because the Stanford Ponzi scheme involved sales of certificates of deposit allegedly backed by covered securities—namely, highly liquid, publicly traded securities. They each also argued that the Fifth Circuit’s decision to allow the class actions cannot comport with either the plain text of SLUSA or the Court’s consistently broad interpretation of the phrase “in connection with.”

In response to these petitions and briefs, the class argued that the Fifth Circuit correctly held that the certificates of deposit are not “covered securities” for the purposes of SLUSA. Moreover, while the sale of the certificates of deposit potentially involved misstatements “about” covered securities, those representations were made only “in connection with the purchase or sale of” the certificates of deposit, not any “covered security.”

At oral argument the Court wrestled with the idea that a false statement concerning whether securities have been purchased may satisfy the “in connection with” requirement. In particular, Justices Kagan and Breyer indicated that they would be uncomfortable with allowing such claims to proceed in state court. The Court also questioned to what extent a ruling in favor of the plaintiffs would affect the SEC. In response to these questions, the U.S. Solicitor General argued for the defendants (as it did in its amicus brief)

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[6] Petition for Writ of Certiorari, *Willis of Colorado Inc. v. Troice* (July 18, 2012), http://sblog.s3.amazonaws.com/wp-content/uploads/2012/08/12-86-Willis-Cert-Petition.pdf.

[7] Petition for Writ of Certiorari, *Proskauer Rose, LLP & Parke, LLP v. Troice* (July 18, 2012), http://sblog.s3.amazonaws.com/wp-content/uploads/2012/08/12-88-Proskauer-cert.petition.pdf.

advocating that if such lawsuits are allowed they would conflict with Congress's intent to provide the SEC with "ability to protect the securities markets against a variety of different forms of fraud."

The Court is expected to rule on these cases before its term ends in late June 2014.

II. Securities Law Cases

In addition to the Supreme Court's consideration of *Halliburton* and the cases involving the Stanford Ponzi scheme (as described above), the last half of 2013 witnessed some notable decisions in securities law cases, two of which are highlighted below.

***In re ProShares Trust Sec. Litig*.**[8]

In re Bank of Am. AIG Disclosure Sec. Litig.[9]

On July 22, 2013, the U.S. Court of Appeals for the Second Circuit in *ProShares* emphasized that disclosures must be read "cover-to-cover" with all representations "taken together and in context" when it affirmed the dismissal of Section 11 claims under the Securities Act of 1933 ("Securities Act") brought against ProShares Trust for allegedly inadequate disclosures in its prospectuses for exchange-traded funds.

This decision is significant in two respects.

First, the decision emphasized the need to read disclosures in their entirety by noting "the role of the materiality

[8] 728 F.3d 96 (2d. Cir. 2013), http://caselaw.findlaw.com/us-2nd-circuit/1639613.html.

[9] 2013 WL 5878814 (S.D.N.Y. Nov. 1, 2013), http://www.wlrk.com/docs/BOA%20%2011-1-13%20%20SDNY%2011-6678.pdf.

requirement is not to attribute to investors a child-like simplicity."

Second, the decision may be extended beyond Section 11 claims. For example, on November 1, 2013, the U.S. District Court for the Southern District of New York in *In re Bank of Am. AIG Disclosure Sec. Litig.*, followed the holding in *ProShares* to dismiss a shareholder action alleging violations of Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act") and Rule 10b-5 thereunder. In dismissing the claims, the Court cited *ProShares* in support for the assertion that the defendants "had no duty to say more" because "no investor could read these disclosures without understanding" the information that the shareholders alleged should have been disclosed.

III. Insider Trading Cases

During the last half of 2013, the SEC and the U.S. Department of Justice ("DOJ") continued to pursue insider trading cases against companies and individuals in the financial industry, including several prominent cases against investment advisers and hedge fund managers.

After bringing nearly 50 enforcement actions alleging insider trading violations this year, the SEC has now brought over 200 insider trading actions over the last four years.[10] As indicated in recent speeches by SEC officials, cracking down on insider trading will continue to be a priority in the year to come.[11] Similarly, the DOJ (in particular, the U.S. Attorney's Office for the Southern District of New York) also continues to prosecute high-profile insider trading cases against members of the investment community. Indeed, U.S. Attorney Preet Bharara's office alone has convicted approximately 77 defendants for insider trading since 2009.[12]

[10] Release, U.S. Securities and Exchange Commission, SEC Announces Enforcement Results for FY 2013, Rel. No. 2013-264 (Dec. 17, 2013), http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370540503617.

[11] *See, e.g.*, Speech, Deploying the Full Enforcement Arsenal, Delivered by SEC Chair Mary Jo White before the Council of Institutional Investors (Sept. 26, 2013) ("We need to continue bringing insider trading cases . . . ."), http://www.sec.gov/News/Speech/Detail/Speech/1370539841202#.UomizRb9E9U.

[12] Maureen Farrell, *Preet Bharara Remains Undefeated for Insider Trading Trials*, THE WALL STREET JOURNAL (Dec. 18, 2013), http://blogs.wsj.com/moneybeat/2013/12/18/preet-bharara-remains-undefeated-for-insider-trading-trials/.

The government's focus on bringing insider trading cases seems to be unfazed by the SEC's defeats in the Mark Cuban insider trading trial (as discussed in our previous Executive Alert) and, more recently, the Larry Schvacho insider trading trial.[13] After the Cuban trial, an SEC spokesman reemphasized the SEC's focus when he stated: "While the verdict in this particular case is not the one we sought, it will not deter us from bringing and trying cases where we believe defendants have violated the federal securities laws."

Below are descriptions of the most notable insider trading cases from the second half of 2013.

SAC Capital Insider Trading Proceedings

Several significant developments occurred over the last six months of 2013 concerning the ongoing civil and criminal investigations into SAC Capital Advisors, LP ("SAC Capital"), Steven Cohen's hedge fund that previously had approximately $15 billion in assets under management.[14] In particular, these investigations resulted in civil and criminal actions by the SEC and DOJ against SAC Capital, its subsidiaries and eight of its employees.

Background. Between January 2010 and July 2013, the SEC and DOJ brought insider trading actions against certain SAC Capital subsidiaries and eight of their employees, who held positions as research analysts or portfolio managers. Six of these employees have pled guilty to charges of securities fraud and conspiracy to commit securities fraud, and have either been sentenced or are awaiting sentencing.[15] Portfolio manager Richard Lee was the sixth and latest employee to plead guilty to insider trading charges and cooperate with the government's

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[13] *U.S. Sec. and Exch. Comm'n v. Schvacho*, No. 12-CIV-02557 (N.D. Ga. Jan. 7, 2014), http://articles.law360.s3.amazonaws.com/0499000/499822/Findings.pdf.

[14] For a detailed discussion of these proceedings, please see: Marc D. Powers, Andrew W. Reich and Yulia M. Fradkin, *Top 10 SEC Enforcement Matters*, Hedge Funds and Private Equity Regulatory & Risk Management Update (Jan. 17, 2014).

[15] Five of these employees include: research analyst Jon Horvath; research analyst Wes Wang; portfolio manager Donald Longueuil; portfolio manager Noah Freeman; and research analyst Richard Choo-Beng Lee. *See* Press Release, U.S. Department of Justice, Manhattan U.S. Attorney And FBI Assistant Director-In-Charge Announce Insider Trading Charges Against Four SAC Capital Management Companies And SAC Portfolio Manager (July 25, 2013), http://www.justice.gov/usao/nys/pressreleases/July13/SACPR.php.

investigation. The other two SAC Capital employees charged with insider trading are portfolio managers Mathew Martoma and Michael Steinberg.

***Matthew Martoma Proceedings**.* The SEC and DOJ each charged Mathew Martoma with insider trading in November and December of 2012, respectively.[16] The allegations against Martoma related to trading on inside information that Martoma obtained from a neurologist regarding an Alzheimer's drug and related pharmaceutical testing in 2008. Specifically, based on this information, Martoma allegedly built a long position in the stock of two pharmaceutical companies, Wyeth Pharmaceuticals and Elan Corporation. It is also alleged that Martoma built up those positions even though analysts at CR Intrinsic Investors, LLC (an investment adviser and wholly-owned subsidiary of SAC Capital) advised against such action. As a result of these trades, SAC Capital allegedly made nearly $276 million in profits. Martoma's criminal trial began on January 7, 2014, before Judge Paul Gardephe, and is scheduled to last more than three weeks. The SEC's civil case against Martoma is still pending.

Michael Steinberg Proceedings. The SEC and DOJ each charged Steinberg with insider trading in March 2013 in connection with short selling Dell shares and NVIDIA Corporation shares prior to earnings announcements.[17] They each alleged that Steinberg, a portfolio manager working for Sigma Capital Management (a wholly-owned subsidiary of SAC Capital), traded on non-public material information obtained from analysts at investment firms. Steinberg was the first SAC Capital employee to go to trial, which began on November 19, 2013, before Judge Richard Sullivan. During the criminal trial, a former SAC Capital analyst Jon Horvath, who had pled guilty on the eve of his own trial, testified on the government's behalf. On

[16] Release, U.S. Securities and Exchange Commission, *Securities and Exchange Commission v. CR Intrinsic Investors*, Rel. No. 22539 (Nov. 20, 2012), http://www.sec.gov/litigation/litreleases/2012/lr22539.htm; Indictment, *United States v. Mathew Martoma* (Dec. 21, 2012), http://www.justice.gov/usao/nys/pressreleases/December12/MathewMartomaIndict/Martoma,%20Mathew%20Indictment.pdf.

[17] Release, U.S. Securities and Exchange Commission, SEC Charges Sigma Capital Portfolio Manager With Insider Trading, Rel. No. 2013-49 (Mar. 29, 2013), http://www.sec.gov/News/PressRelease/Detail/PressRelease/1365171513522; Release, U.S. Department of Justice, Manhattan U.S. Attorney And FBI Assistant Director-In-Charge Announce Insider Trading Charges Against Hedge Fund Portfolio Manager (Mar. 29, 2013), http://www.justice.gov/usao/nys/pressreleases/March13/SteinbergArrestPR.php.

December 18, 2013, Steinberg was found guilty of four counts of securities fraud and one count of conspiracy to commit securities fraud, and faces a sentence of 20 years for each count of securities fraud and 5 years for the conspiracy charge. According to reports, the government remains interested in using Steinberg as a cooperating witness in pending SAC Capital cases (as described below). The SEC's civil case against Steinberg is still pending.

Steven Cohen Administrative Proceeding. On July 19, 2013, the SEC instituted an administrative proceeding against Cohen in his capacity as founder and owner of SAC Capital for allegedly failing to supervise Steinberg and Martoma, and prevent their violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.[18] According to allegations in the SEC's administrative complaint, Cohen learned of red flags that Steinberg and Martoma were trading on material non-public information, including through verbal and email communications with Steinberg and Martoma, verbal and email communications with other SAC Capital employees, and in Martoma's case, email communications with CR Intrinsic analysts. Despite this knowledge, Cohen allegedly failed to investigate the trades to ensure compliance with the law and instead rewarded the traders by congratulating Steinberg and giving Martoma a $9 million bonus.

SAC Capital Indictment. On July 25, 2013, the DOJ unsealed an indictment and filed a civil forfeiture action against SAC Capital, SAC Capital Advisors LLC and SAC Capital's wholly-owned subsidiaries CR Intrinsic Investors, LLC and Sigma Capital Management, on charges of securities fraud and wire fraud for alleged misconduct occurring between 1999 through 2010. Upon announcing its indictment, U.S. Attorney Preet Bharara called SAC Capital "a veritable magnet of market cheaters" and stated that "[a] company reaps what it sows, and as alleged, S.A.C. seeded itself with corrupt traders, empowered to engage in criminal acts by a culture that looked the other way despite red flags all around."[19] The indictment detailed

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[18] Release, U.S. Securities and Exchange Commission, SEC Charges Steven A. Cohen With Failing to Supervise Portfolio Managers and Prevent Insider Trading, Rel. No. 2013-129 (July 19, 2013), https://www.sec.gov/News/PressRelease/Detail/PressRelease/1370539726923.

[19] Release, U.S. Department of Justice, Manhattan U.S. Attorney And FBI Assistant Director-In-Charge Announce Insider Trading Charges Against Four SAC Capital Management Companies And SAC Portfolio Manager

specific instances of insider trading within a larger fraudulent scheme. Although the indictment did not name Cohen, it did reference the eight SAC Capital employees (previously mentioned in this Report) in its factual allegations. The government also cited to emails sent and received by SAC Capital executive management, including Cohen, in connection with the alleged illegal trades, to argue that the executives knew of the illegal trading but turned a blind eye.

On November 4, 2013, the government settled with SAC Capital and its subsidiaries.[20] Pursuant to the terms of the settlement, SAC Capital and its subsidiaries agreed to plead guilty, pay a $1.8 billion penalty (the largest insider trading penalty in history), cease operating as investment advisers and stop accepting third-party funds. Each of these four companies was also required to submit to the maximum five-year probationary period and retain a compliance monitor. The effect of the settlement is that SAC Capital now operates as a family office that manages the Cohen family's money. The $1.8 billion penalty was comprised of $900 million in connection with the criminal charges and $900 million in connection with the civil forfeiture case. The civil forfeiture fee subsumed the $615.7 million settlement between the SEC and SAC Capital and its subsidiaries, entered into in March 2013 in connection with related civil charges of insider trading (as discussed in our Mid-Year Report). The agreement expressly settled all criminal charges against SAC Capital and its affiliates, but did not preclude criminal actions against individuals. The civil forfeiture portion of the settlement has been approved, but the criminal portion is still pending approval by Judge Laura Swain, with determination expected at a sentencing hearing scheduled for March 14, 2014.

Galleon-Related Insider Trading Case

On November 21, 2013, the SEC brought settled civil charges of federal securities fraud violations against Sam Miri, a former employee of Marvell Technology Group, for allegedly tipping confidential information about the company's financial performance to former Galleon

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(July 25, 2013), http://www.justice.gov/usao/nys/pressreleases/July13/SACPR.php.

[20] Release, U.S. Department of Justice, Manhattan U.S. Attorney Announces Guilty Plea Agreement With SAC Capital Management Companies (Nov. 4, 2013), http://www.justice.gov/usao/nys/pressreleases/November13/SACPleaPR.php.

Management portfolio manager Ali Far who traded on that information on behalf of hedge funds that he founded after he left Galleon.[21] Without admitting or denying the charges, Miri agreed to pay $10,000 in disgorgement, $1,842.90 in prejudgment interest, a $50,000 civil penalty, to be barred from serving as an officer or director of a public company for five years, and to be permanently enjoined from future violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

Miri is the thirty-fifth defendant (including individuals and entities) held accountable as a result of the government's ongoing investigation of the Galleon insider trading scheme.

Carter's Insider Trading Cases

The hedge fund industry also featured prominently in insider trading cases relating to Carter's, Inc., a well-known Atlanta clothing manufacturer.

Dennis Rosenberg SEC Settlement. On October 29, 2013, the SEC brought settled civil charges of federal securities fraud violations against Dennis Rosenberg, a retired New York hedge fund manager and market analyst, alleging that he traded on material nonpublic information about Carter's that he learned from a former Carter's executive and tipped two unnamed investment advisers with this information who also traded on it.[22] Pursuant to the settlement (in which Rosenberg neither admitted nor denied misconduct), Rosenberg consented to be permanently enjoined from future violations of the anti-fraud provisions of the federal securities laws and to pay approximately $600,000 in disgorgement and prejudgment interest. Based on the allegations and the postponement of the civil penalty determination, it appears that Rosenberg is cooperating with the SEC's investigation.

Mark Megalli Proceedings. On November 14, 2013, the SEC and DOJ brought similar charges in the U.S. District Court for the Northern District of Georgia against Mark Megalli, a New York-based hedge fund manager, alleging that Megalli traded on material nonpublic information about

[21] Release, U.S. Securities and Exchange Commission, SEC Charges Another Tipper in Galleon Insider Trading Scheme, Rel. No. 2013-247 (Nov. 21, 2013), http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370540396057.

[22] Release, U.S. Securities and Exchange Commission, SEC Charges New York Investment Professional with Insider Trading, Rel. No. 22858 (Oct. 29, 2013), http://www.sec.gov/litigation/litreleases/2013/lr22858.htm.

Carter's, netting his hedge fund, Level Global Investors L.P., $3.2 million.[23] Although the SEC action is still pending, Megalli pled guilty to the criminal charges on November 14, 2013.[24]

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[23] Release, U.S. Securities and Exchange Commission, SEC Charges Hedge Fund Trader with Insider Trading in Carter's Stock, Rel. No. 2013-244 (Nov. 14, 2013), http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370540374789.

[24] Release, U.S. Department of Justice, Former Portfolio Manager For New York Hedge Fund Pleads Guilty To Multi-Million Dollar Insider Trading Conspiracy (Nov. 14, 2013), http://www.justice.gov/usao/gan/press/2013/11-14-13.html.

IV. Settlements

This last year witnessed some of the largest settlements related to the Financial Crisis. According to a paper published by National Economic Research Associates, Inc. ("NERA"), the number and size of settlements significantly increased with approximately $19 billion in settlements from January through October.[25] NERA also noted that, through October 2013, 17 cases involving asset-backed and mortgage backed securities settled for a total value of $6.6 billion.

According to NERA, securities class action settlements continued at a slow pace after 2012 record low. Only 100 securities class actions settled in 2013, just above the 94 cases settled in 2012. While the aggregate settlement amount exceeded $6.5 billion (almost doubling the 2012 total), the amount is skewed by 9 settlements exceeding $100 million, including Bank of America's $2.4 billion settlement related to its acquisition of Merrill Lynch & Co ("Merrill Lynch"). The median settlement in 2013 was $9.1 million, a 26% decrease from 2012.

This past half year also witnessed significant developments with respect to regulatory settlements. In particular, the SEC departed from its long-standing practice of allowing defendants to settle without admitting or denying liability. As we discussed in our previous Executive Alert, the first of

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[25] Dr. Faten Sabry, Eric Wang and Joseph Mani, *Credit Crisis Litigation Update: It is Settlement Time*, NERA (Oct. 31, 2013), http://www.nera.com/nera-files/PUB_Subprime_Series_Part_X_Credit_Crisis_Update_1113.pdf.

these settlements occurred on August 19, 2013, when the SEC announced that Philip Falcone and his advisory firm Harbinger Capital Partners agreed to an $18 million settlement, which required Falcone and Harbinger to admit to acting "recklessly" and to multiple acts of misconduct, including that Falcone improperly borrowed millions of dollars to pay personal tax obligations. As discussed below, the Commodity Futures Trading Commission ("CFTC") also is now poised to seek admission of wrongdoing in certain high-profile cases.

The most noteworthy settlements from the last half of 2013 are highlighted below.

Civil Settlements

JPMorgan $13 Billion RMBS Settlement. On November 19, 2013, the DOJ announced that JPMorgan Chase & Co. ("JPMorgan") agreed to pay $13 billion to settle federal and state civil claims arising out of the packaging, marketing, sale and issuance of residential mortgage-backed securities ("RMBS") by JPMorgan, Bear Stearns and Washington Mutual.[26] The settlement is the largest penalty levied against a single entity in American history. As part of the settlement, JPMorgan acknowledged that it regularly represented that mortgage loans in various securities complied with underwriting guidelines despite knowing that such representations were false. Significantly, the settlement does not remove the threat of possible criminal prosecution against JPMorgan or its employees for the same conduct.

JPMorgan agreed to pay $9 billion as a civil penalty with $2 billion going to settle claims with the DOJ; $1.4 billion to settle claims with the National Credit Union Administration, $515.4 million to settle claims with the Federal Deposit Insurance Corporation ("FDIC"); $4 billion to settle claims by the Federal Housing Finance Agency ("FHFA"); $298.9 million to settle claims by the State of California; $19.7 million to settle claims by the State of Delaware; $100 million to settle claims by the State of Illinois; $34.4 million to settle claims by the Commonwealth of Massachusetts; and $613 million to settle claims by the State of New York. JPMorgan also agreed to pay $4 billion in consumer relief, including principal forgiveness, loan modification, targeted

[26] Release, U.S. Department of Justice, Justice Department, Federal and State Partners Secure Record $13 Billion Global Settlement with JPMorgan for Misleading Investors about Securities Containing Toxic Mortgages (Nov. 19, 2013), http://www.justice.gov/opa/pr/2013/November/13-ag-1237.html.

originations in low-income neighborhoods and programs to reduce blight.

Mortgage Backed Securities Case Settlements. The FHFA recovered nearly $8 billion in 2013 from settlements with seven large banks to settle litigation related to the sales of mortgage-backed securities to Fannie Mae and Freddie Mac. The FHFA, which serves as the conservator for Fannie Mae and Freddie Mac, sued 17 banks in September 2011 regarding the quality of $182 billion in mortgages underlying securities sold to Fannie Mae and Freddie Mac.

General Electric was the first institution to settle with the FHFA, agreeing to pay $6.25 million in January 2013.[27] Citigroup agreed to pay $250 million in May 2013 to settle FHFA's claims that it misled Fannie Mae and Freddie Mac in their purchase of $3.5 billion in mortgage-backed securities.[28] UBS Americas Inc. followed with an $885 million settlement in July 2013, resolving four different actions in New York and California federal courts.[29] On October 29, 2013, FHFA announced its largest settlement to date—a $5.1 billion settlement with JPMorgan, which was partially funded by JPMorgan's $13 billion settlement discussed above.[30] Also on October 29, 2013, Ally Financial Inc. reached a $475 million agreement to settle claims with FHFA and the FDIC.[31] Wells Fargo & Co. paid FHFA $335 million in November 2013.[32] In December 2013, Deutsche Bank AG agreed to pay $1.9 billion ($1.63 billion to Freddie Mac and $300 million to Fannie Mae).[33]

FHFA has 12 outstanding cases, including actions against Bank of America, HSBC PLC, Morgan Stanley and Barclays Bank PLC ("Barclays").

***In re Citigroup Inc. Bond Litig.*, No. 1:08-cv-09522 (S.D.N.Y.)**. On August 20, 2013, the U.S. District Court for

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[27] *Federal Housing Finance Agency v. General Electric Co.*, No. 1:11-cv-07048 (S.D.N.Y.).

[28] *Federal Housing Finance Agency v. Citigroup Inc.*, No. 1:11-cv-06196 (S.D.N.Y.).

[29] *Federal Housing Finance Agency v. UBS Americas Inc.*, No. 1:11-cv-05201 (S.D.N.Y.).

[30] *Federal Housing Finance Agency v. JPMorgan Chase & Co.*, No. 1:11-cv-06188 (S.D.N.Y.).

[31] *In re Residential Capital LLC*, No. 1:12-bk-12020 (Bankr. S.D.N.Y.).

[32] FHFA did not file a suit against Well Fargo.

[33] *Federal Housing Finance Agency v. Deutsche Bank AG,* No. 1:11-cv-06192 (S.D.N.Y.).

the Southern District of New York approved a $730 million settlement to resolve an investor class action against Citigroup Inc. ("Citigroup"), alleging that the bank misled investors with respect to its exposure to collateralized debt obligations ("CDOs") backed by subprime assets. The settlement is one of the 15 largest recoveries in a securities class action and the second-largest recovery in a securities class action brought on behalf of purchasers of debt securities. The settlement ends four years of litigation initiated by purchasers of 48 offerings of Citigroup preferred stock and bonds issued from 2006 through 2008. The plaintiffs alleged that Citigroup made false statements about its exposure to $66 billion in CDOs backed by subprime assets.

Regulatory Settlements

***In the Matter of JPMorgan Chase Bank, N.A.*, CFTC Dkt. No. 14-01**. On October 16, 2013, the CFTC issued a consent order against JPMorgan, in which the bank admitted to specified factual findings, including that its traders acted recklessly in connection to its $6 billion "London Whale" credit-default swap loss.[34] Pursuant to the order, JPMorgan agreed to pay a $100 million civil monetary penalty after agreeing to pay $920 million to settle similar claims by the SEC, the Board of Governors of the Federal Reserve System ("Federal Reserve Board"), the Office of the Comptroller of the Currency ("OCC") and the U.K. Financial Conduct Authority ("FCA") on September 19, 2013. JPMorgan also agreed to continue to implement written enhancements to its supervision and control system in connection with its swaps trading activity. Notably, CFTC Commissioner Bart Chilton signaled that the CFTC would pursue more admissions in certain cases, stating that they would not have supported the settlements without admissions and that "[a]ll too often, a firm will neither admit nor deny any wrongdoing. That needs to stop."

***United States v. Rabobank*, (D. Conn.)**. As described more fully in the CFTC section of this Report, on October 29, 2013, Dutch lender Rabobank entered into a deferred prosecution agreement ("DPA") with the DOJ and agreed to pay a $325 million penalty to resolve violations arising from allegations that it manipulated LIBOR. Rabobank also

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[34] Release, Commodity Futures Trading Commission CFTC Files and Settles Charges Against JPMorgan Chase Bank, N.A., For Violating Prohibition on Manipulative Conduct In Connection with "London Whale" Swaps Trades, Rel. No. PR6737-13 (Oct. 16, 2013), http://www.cftc.gov/PressRoom/PressReleases/pr6737-13.

agreed to pay $475 million to the CFTC, $170 million to the FCA and $96 million to the Dutch Public Prosecution Service for a total of over $1 billion in civil and criminal fines. Rabobank also announced the resignation of its chairman.

Rabobank became the fifth financial institution to settle claims arising out of the LIBOR manipulation investigation. Barclays PLC had previously paid $450 million in June 2012. UBS AG ("UBS") paid approximately $1.5 billion in December 2012, Royal Bank of Scotland PLC paid $612 million in February 2013. ICAP Europe Limited ("ICAP") settled for $87.4 million in September 2013.

***In the Matter of Merrill Lynch Pierce Fenner & Smith Inc.*, Proc. No. 3-15642**. On December 12, 2013, Merrill Lynch agreed (without admitting or denying wrongdoing) to pay $131.8 million (in the form of a civil penalty and disgorgement with prejudgment interest) to settle SEC charges that it had made faulty disclosures about collateral selection for two CDOs that it had structured and marketed to its investors.[35] According to the SEC, Merrill Lynch failed to disclose to investors that hedge fund Magnetar Capital exercised significant influence over the selection of the underlying collateral. Magnetar bought the equity in the CDOs but hedged its position by shorting against the securities.

The settlement marks the latest involving alleged misconduct of financial firms that marketed CDOs before the financial crisis. In July 2010, Goldman Sachs agreed to pay $550 million to settle charges it failed to disclose to investors that hedge fund Paulson & Co. helped select a CDO portfolio while also shorting the deal. More recently, on August 6, 2013, UBS agreed to pay $50 million to settle charges that it had misled investors by marketing a CDO without disclosing that it had retained millions of dollars in upfront cash it received in the course of acquiring the capital.[36]

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[35] Release, U.S. Securities and Exchange Commission, SEC Charges Merrill Lynch With Misleading Investors in CDOs, Rel. No. 2013-261 (Dec. 12, 2013), http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370540492377.

[36] Release, U.S. Securities and Exchange Commission, UBS to Pay $50 Million to Settle SEC Charges of Misleading CDO Investors, Rel. No. 2013-146 (Aug. 6, 2013), http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370539751175.

Municipal Bond Settlements

Following the pattern noted in our Mid-Year Report, the SEC continued to target participants in the municipal bond market.

***In the Matter of City Sec. Corp. and Randy Ruhl*, Proc. No. 3-15390; *In the Matter of West Clark Cmty. Sch.*, Proc. No. 3-15391**. On July 29, 2013, the SEC charged a school district in Indiana, its municipal bond underwriter, and a senior manager of the underwriter for falsely stating to bond investors that the school district had complied with disclosure requirements in prior bond offerings.[37] The school district allegedly failed to submit the required annual financial reports and notices for a 2005 bond offering. In a subsequent $31 million offering in 2007, the school district stated that it was in compliance with its disclosure obligations while the bond underwriter did not conduct adequate due diligence to detect the false statement. This case is significant in that it is the first time the SEC has charged a municipal issuer for false claims regarding its compliance with disclosure obligations under prior offerings by the issuer. It is also the first time an underwriter has been charged with failing to detect such false claims. Pursuant to the consent orders (in which the respondents neither admitted nor denied misconduct), the respondents agreed to be censured. While the underwriter and its senior manager agreed to each pay civil penalties and disgorgement with prejudgment interest of approximately $580,000 and $38,000 respectively, the school district was not subject to a civil penalty or disgorgement. The underwriter's senior manager was also barred from the securities industry for one year and permanently barred from acting as a supervisor in the securities industry. In entering into the consent order, the SEC recognized certain remedial measures undertaken by the respondents, including adopting written policies and procedures by the school district and underwriter, annual training by the school district, and engaging an independent compliance consultant by the underwriter.

***In the Matter of The Greater Wenatchee Regional Events Ctr. Pub. Facilities Dist.*, Proc. No. 3-15602; *In the Matter of Piper Jaffray & Co.*, Proc. No. 3-15603**.

[37] Release, U.S. Securities and Exchange Commission, SEC Charges School District and Muni Bond Underwriter in Indiana with Defrauding Investors, Rel. No. 2013-136 (July 29, 2013), http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370539734122.

On November 5, 2013, for the first time, the SEC assessed a financial penalty against a municipal underwriter. The SEC charged a municipal bond issuer in the State of Washington, its underwriter, its outside developer, and three individuals for allegedly misleading investors about a bond offering that financed the development of an ice-hockey arena.[38] According to the SEC, the Greater Wenatchee Regional Events Center Public Facilities District ("Wenatchee") failed to disclose that financial projections about the arena's economic viability and withheld information about Wenatchee's debt capacity. The SEC levied a $20,000 penalty against Wenatchee, a $300,000 and $25,000 penalty against the underwriter and lead investment banker respectively, and $10,000 penalties against the outside developer and its CEO. Notably, the SEC required that the penalty levied against Wenatchee would be paid from operating funds without directly impacting taxpayers. None of the respondents admitted or denied misconduct in consenting to the entry of the orders. Pursuant to the orders, Wenatchee agreed to train its personnel involved in the offering and disclosure process, establish policies, procedures and internal controls relating to disclosures, and the underwriter agreed to retain an independent consultant to review its municipal underwriting due diligence process and supervisory practices.

[38] Release, U.S. Securities and Exchange Commission, SEC Charges Municipal Issuer in Washington's Wenatchee Valley Region for Misleading Investors, Rel. No. 2013-235 (Nov. 5, 2013), http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370540262235.

V. Investment Adviser and Hedge Fund Cases

During the last half of 2013, the SEC continued to bring enforcement actions against investment advisors and managers for, among other things, compliance and disclosure violations.

The SEC's Compliance Program Initiative[39]

On October 23, 2013, the SEC, pursuant to its Compliance Program Initiative, announced consent orders with three investment advisors (in which they neither admitted nor denied misconduct) for failing to improve their compliance programs despite warnings from the SEC. This initiative, Co-Director of SEC Enforcement Andrew Ceresney explained, "is designed to address repeated compliance failures that may lead to bigger problems."

Modern Portfolio Management SEC Settlement. According to the consent order with Modern Portfolio Management, Inc. ("MPM"), its CCO and its President,[40] the

[39] Release, U.S. Securities and Exchange Commission, SEC Sanctions Three Firms Under Compliance Program Initiative, Rel. No. 2013-226 (Oct. 23, 2013), http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370540008287.

[40] *In the Matter of Modern Portfolio Management, Inc., G. Thomas Damasco II, and Bryan F. Ohm,* Investment Advisers Act Rel. No. 3702, Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Sections 203(e), 203(f) and 203(k) of the Investment Advisers Act of 1940 and Section 15(b)(6) of the Investment Advisers Act of 1940, Making Findings and Imposing Remedial Sanctions and a Cease-and-Desist Order (Oct 23, 2013), http://www.sec.gov/litigation/admin/2013/ia-3702.pdf.

respondents allegedly violated Sections 206(2) and 206(4) of the Investment Advisers Act of 1940 ("Advisers Act") and Rules 206(4)-7 and 206(4)-1(a)(5) thereunder by, among other things, repeatedly failing to conduct annual compliance reviews in 2006 and 2009 and making misleading disclosures in its marketing materials regarding its amount of assets under management, investment access, and performance. The SEC, in entering into the consent order with respondents, considered their cooperation and remedial measures, including that MPM engaged a compliance consultant to advise it on compliance issues during the SEC investigation. The respondents were all censured, required to cease and desist from committing future violations of the respective sections of the Advisers Act, and ordered to pay a civil penalty of $75,000, $50,000 and $50,000, respectively. The order also required that the CCO and President complete compliance training and that MPM designate a new CCO and retain a compliance consultant for three years.

Equitas SEC Settlements. According to the consent order with Equitas Capital Advisors, LLC, Equitas Partners, LLC, their CEO and one of their respective CCOs, the respondents allegedly violated Sections 206(2), 206(4) and 207 of the Advisers Act and Rules 206(4)-7 and 206(4)-1(a)(5) thereunder by, among other things, failing to conduct annual compliance reviews, failing to maintain written compliance policies and procedures, committing inadvertent billing errors, and making misrepresentations to clients about historical performance, compensation, conflicts of interest, and prior examination deficiencies. These alleged violations occurred despite warnings the SEC provided to the respondents in connection with their examinations in 2005, 2008 and 2011.[41] The respondents were all required to cease and desist from committing future violations of the respective sections of the Advisers Act, the Equitas entities were both censured and ordered to pay a civil penalty of $100,000 and the CEO was ordered to pay a civil penalty of $35,000. The Equitas entities were also required to retain an independent compliance consultant for

[41] *In the Matter of Equitas Capital Advisors, LLC, Equitas Partners, LLC, David S. Thomas, Jr, and Susan Christina,* Exchange Act Rel. No. 70743, Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Sections 203(e), 203(f) and 203(k) of the Investment Advisers Act of 1940 and Section 15(b)(6) of the Securities Exchange Act of 1934, Making Findings and Imposing Remedial Sanctions and a Cease-and-Desist Order (Oct. 23, 2013), http://www.sec.gov/litigation/admin/2013/34-70743.pdf.

three years and provide its advisory clients with a copy of the order.

In a separate consent order with the former CCO of Equitas Partners for alleged involvement with the same violations described above, the respondent was ordered to cease and desist from committing future violations of the respective sections of the Advisers Act, pay a civil money penalty of $90,000 and provide a copy of the order to the clients that were overcharged.[42] The SEC, in entering into the consent order with the respondent, considered his remedial acts, including relinquishing his role as CCO, hiring an independent compliance consultant, reimbursing some of his clients for improperly billed advisory fees and implementing a new, more automated billing system.

Sovereign International Asset Management[43]

On November 20, 2013, the SEC instituted administrative proceedings against two investment advisers for alleged violations of Section 17(a) of the Securities Act, Section 15(a) of the Exchange Act, Sections 206(1), 206(2), 206(3), 206(4) and 207 of the Advisers Act and Rules 204-3 and 206(4)-2 thereunder.[44] According to the order, the respondents (both managing partners and owners of Sovereign International Asset Management during the relevant time period) allegedly committed fraud by failing to truthfully inform clients about compensation received from offshore funds they recommended as safe investments despite substantial risks and red flags. The order also alleged that respondents violated the "custody rule" (which requires investment advisers to establish specific procedures to safeguard and account for client assets) by

[42] *In the Matter of Stephen Derby Gisclair*, Exchange Act Rel. No. 70742, Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Sections 203(f) and 203(k) of the Investment Advisers Act of 1940 and Section 15(b)(6) of the Securities Exchange Act of 1934, Making Findings, And Imposing Remedial Sanctions and a Cease-and-Desist Order (Oct. 23, 2013), http://www.sec.gov/litigation/admin/2013/34-70742.pdf.

[43] Release, U.S. Securities and Exchange Commission, SEC Announces Fraud Charges Against Two Florida-Based Investment Advisers, Rel. No. 2013-245 (Nov. 20, 2013), http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370540393775.

[44] *In the Matter of Larry C. Grossman and Gregory J. Adams*, Securities Act Rel. No. 9481, Order Instituting Administrative And Cease-And-Desist Proceedings Pursuant To Section 8A Of The Securities Act Of 1933, Sections 15(b) And 21C Of The Securities Exchange Act Of 1934, Sections 203(f) And 203(k) Of The Investment Advisers Act Of 1940, And Section 9(b) Of The Investment Company Act Of 1940 (Nov. 20, 2013), http://www.sec.gov/litigation/admin/2013/33-9481.pdf.

pooling client money in a bank account controlled by a related entity.

In instituting the order, Director of the SEC's Miami Regional Office Eric I. Bustillo stated: "Investment advisers have a fiduciary duty to act in utmost good faith when recommending investments, and they must fully disclose all of the relevant facts to their clients."

A hearing before an administrative law judge is anticipated for early 2014.

Chariot Advisors, LLC[45]

On August 21, 2013, as part of an initiative to focus on Section 15(c) of the Investment Company Act of 1940 ("Investment Company Act"), the SEC instituted an administrative proceeding against an investment adviser and its former owner for allegedly misleading an investment fund's board of directors about the adviser's ability to conduct algorithmic currency trading, resulting in violations of Section 15(c) and 34(b) of the Investment Company Act and Sections 206(1), 206(2) and 206(4) of the Advisers Act and Rule 206(4)-8 thereunder. According to the order, Chariot Advisors, LLC and Elliot L. Shifman misled the board about the nature, extent, and quality of its services in two presentations to obtain the board's approval to manage the fund and ultimately caused misrepresentations and omissions in the fund's registration statement and prospectus filed with the SEC. In particular, after the fund was launched, Chariot allegedly hired a trader who exercised trade discretion to manage the fund's assets instead of implementing an algorithm model to perform the fund's currency trading.

In instituting the administrative proceeding, Co-Chief of the SEC's Asset Management Unit Julie M. Riewe stated: "It is critical that investment advisers provide truthful information to the directors of the registered funds they advise" because "[b]oth boards and advisers have fiduciary duties that must be fulfilled to ensure that a fund's investors are not harmed."

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[45] *In the Matter of Chariot Advisors, LLC and Elliott L. Shifman*, Exchange Act Rel. No. 70239, Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Section 15(b)(6) of the Securities Exchange Act of 1934, 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 and Notice of Hearing (Aug. 21, 2013), http://www.sec.gov/litigation/admin/2013/34-70239.pdf.

According to the accompanying SEC release, this order is the third enforcement action related to this initiative over the past few years.[46]

A hearing before an administrative law judge is scheduled for February 10, 2014.[47]

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[46] Release, U.S. Securities and Exchange Commission, SEC Charges North Carolina-Based Investment Adviser for Misleading Fund Board About Algorithmic Trading Ability, Rel. No. 2013-162 (Aug. 21, 2013), http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370539785773.

[47] *In the Matter of Chariot Advisors, LLC and Elliott L. Shifman*, Admin. Proc. No. 3-24533, Prehearing Order (Jan. 14, 2014), http://www.sec.gov/alj/aljorders/2014/ap-1169.pdf.

VI. Commodities and Futures Regulation and Cases

The second half of 2013 witnessed significant regulatory and enforcement developments from the CFTC. As detailed more fully below, the CFTC issued guidance on the cross-border application of U.S. derivatives rules (which was challenged in federal court by financial industry groups), announced the settlement of its first ever "spoofing" case, entered into two additional settlements in connection with its LIBOR manipulation investigation[48] and obtained court approval of its settlement with MF Global.[49]

In fiscal year 2013, the CFTC opened 290 investigations, brought 83 actions and obtained $1.7 billion in sanctions, including orders for more than $1.5 billion in civil monetary penalties and more than $200 million in restitution and disgorgement[50] (approximately $1.1 billion of the $1.7 billion

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[48] Release, Commodity Futures Trading Commission, CFTC Charges ICAP Europe Limited, a Subsidiary of ICAP plc, with Manipulation and Attempted Manipulation of Yen Libor, Rel. No. PR6708-13 (Sept. 13, 2013), http://www.cftc.gov/PressRoom/PressReleases/pr6708-13; Release, Commodity Futures Trading Commission, Rabobank to Pay $475 Million Penalty to Settle Manipulation and False Reporting Charges Related to LIBOR and Euribor, Rel. No. 6752-13 (Oct. 29, 2013), http://www.cftc.gov/PressRoom/PressReleases/pr6752-13.

[49] Release, Commodity Futures Trading Commission, Federal Court in New York Orders MF Global Inc. to Pay over $1 Billion in Restitution to Customers of MF Global Inc., Rel. No. PR6776-13 (Nov. 18, 2013), http://www.cftc.gov/PressRoom/PressReleases/pr6776-13.

[50] Release, Commodity Futures Trading Commission, CFTC Releases Enforcement Division's Annual Results, Rel. No. PR6749-13 (Oct. 24, 2013), http://www.cftc.gov/PressRoom/PressReleases/pr6749-13.

came from settlements with three financial institutions in connection with the CFTC's LIBOR investigations).

CFTC Issues Guidance On Cross-Border Application of Derivatives Rules

Title VII of Dodd-Frank granted the CFTC new powers to oversee the previously unregulated multitrillion dollar over-the-counter swaps market[51] by requiring the CFTC, either individually or jointly with the SEC (which regulates securities-based swaps), to draft and implement a number of rules to regulate the swaps marketplace.

By way of background, Section 722(d) of Dodd-Frank amended the Commodity Exchange Act ("CEA") by adding Section 2(i), which states, among other things, that Dodd-Frank "shall not apply to activities outside the United States" unless those activities "have a direct and significant connection with activities in, or effect on, commerce of the United States." The CFTC has interpreted Section 2(i) of the CEA as "a clear expression of congressional intent" that the swaps provisions of Title VII apply beyond U.S. borders when certain circumstances are present.[52]

On July 12, 2012, the CFTC published for public comment its "proposed interpretive guidance and policy statement" for the "Cross-Border Applications of Certain Swaps Provisions of the Commodity Exchange Act" ("Cross-Border Guidance").[53] On July 26, 2013, the Cross-Border Guidance was finalized and became effective. Among other things, the Cross-Border Guidance addresses: (i) the scope of the term "U.S. Person"; (ii) when swap dealers and "major swap participants" who are not located in the United States must register with the CFTC; (iii) the scope of the term "foreign branch" of a U.S. bank; and (iv) "substituted compliance" for observation of foreign laws.

In December 2013, the Securities Industry and Financial Markets Association ("SIFMA"), the International Swaps and Derivatives Association ("ISDA") and the Institute of International Bankers filed a lawsuit in the District Court for

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[51] Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Dodd-Frank"), Public Law 111-203, 124 Stat. 1376, 1641-1802 (2010).

[52] Interpretive Guidance and Policy Statement Regarding Compliance With Certain Swap Regulations ("Cross-Border Guidance"), 17 Fed. Reg. 45292, 45298 (July 26, 2013).

[53] Proposed Interpretive Guidance and Policy Statement Regarding Compliance With Certain Swap Regulations, 17 Fed. Reg. 41214 (July 12, 2012).

the District of Columbia against the CFTC seeking to vacate the Cross-Border Guidance and enjoining the CFTC from giving extraterritorial effect to its swaps regulations until a "valid" rulemaking regarding extraterritorial application is completed."[54]

The complaint argues, among other things, that the CFTC did not comply with the procedural requirements of the CEA and the Administrative Procedures Act in drafting the Cross-Border Guidance. According to the complaint, the CFTC violated these statutes when it failed to evaluate the costs and benefits of the Cross-Border Guidance, provide interested persons a sufficient opportunity to participate in the rulemaking, and respond adequately to the comments of interested persons. It also argues that, even though the CFTC drafted "guidance" and noted that its terms are non-binding, the CFTC "has made clear at every turn that the [Cross-Border Guidance] is intended to bind Commission staff and the public." The case is still pending.

The CFTC Brings Its First "Spoofing" Case Under Dodd-Frank

In July 2013, the CFTC brought its first "spoofing" enforcement action under Dodd-Frank, simultaneously filing and settling charges against Panther Energy Trading LLC ("Panther") and its sole owner Michael J. Coscia.[55] The CFTC's order requires that Panther pay $2.8 million and bans it from trading for one year.[56]

Section 747 of Dodd-Frank amended Section 4c(a) of the CEA to add Section 4c(a)(5), called "disruptive practices." Among other things, Section 4(c)(a)(5)(c) makes it unlawful for any person to engage in trading that "is of the character of, or is commonly known to the trade as, 'spoofing,'

[54] Complaint, *Sec. Industry and Fin. Mkts. Ass'n v. Commodity Futures Trading Comm'n*, No. 13-CV-1916 (D.D.C. Dec. 4, 2013), https://www.sifma.org/issues/item.aspx?id=8589946488.

[55] Release, Commodity Futures Trading Commission, CFTC Orders Panther Energy Trading LLC and its Principal Michael J. Coscia to Pay $2.8 Million and Bans Them from Trading for One Year, for Spoofing in Numerous Commodity Futures Contracts, Rel. PR6649-13 (July 22, 2013), http://www.cftc.gov/PressRoom/PressReleases/pr6649-13.

[56] Order Instituting Proceedings Pursuant to Sections 6(c) and 6(d) of the Commodity Exchange Act, As Amended, Making Findings and Imposing Remedial Sanctions, In the Matter of Panther Energy Trading LLC and Michael J. Coscia, CFTC Docket No. 13-26, at 2, (July 22, 2013), http://www.cftc.gov/ucm/groups/public/@lrenforcementactions/documents/legalpleading/enfpantherorder072213.pdf.

(bidding or offering with the intent to cancel the bid or offer before execution)."

The CFTC's order (in which Panther neither admitted nor denied misconduct) detailed how, in 2011, Panther allegedly used a computer trading algorithm that was designed to rapidly place bids and offers and then to quickly cancel those bids and offers before execution to trade futures contracts in a number of commodities. For example, Panther allegedly placed offers to sell a small number of futures contracts immediately prior to placing orders to buy relatively large numbers of these same futures contracts, with bids at higher prices than current bids by other market participants. This trading sequence allegedly gave the market the impression that there was significant buying interest in the futures contract and suggested that prices would rise, which made other market participants buy the futures contracts Panther offered to sell. Panther then allegedly cancelled the buy orders before they were actually executed. The algorithm also allegedly operated in reverse, placing a small buy order, followed by large sell orders, which Panther would cancel before execution.

Panther's algorithmic system allegedly cancelled more than 98 percent of 400,000 large orders it placed on domestic commodities exchanges. The CFTC's order against Panther provided that Panther "intended when placing bids or offers to cancel the bids or offers prior to execution," and that they designed and used an algorithmic trading system to accomplish this result. Consistent with the CFTC's interpretive guidance on spoofing,[57] the order does not address Panther or Coscia having any intent to mislead the market.

Additional LIBOR Settlements

The second half of 2013 saw the CFTC settle with two additional financial institutions in connection with its investigation into manipulations of LIBOR: ICAP and

[57] The CFTC's interpretive guidance on spoofing states that a violation requires a market participant to "act with some degree of intent, or scienter, beyond recklessness." While the guidance notes that commenters suggested that there must also be intent to "mislead the market," this was not incorporated. However, according to the guidance, "good faith" cancellations or modifications of orders that are part of a "legitimate, good-faith attempt to consummate a trade" will not result in a spoofing violation. In distinguishing between "legitimate trading" and spoofing, the CFTC will "evaluate the market context, the person's pattern of trading activity (including fill characteristics), and other relevant facts and circumstances."

Rabobank.[58] These settlements (in which ICAP and Rabobank each neither admitted nor denied misconduct) were for $65 million and $475 million, respectively.

As detailed in our 2012 Year-End Report, LIBOR is an interest rate supplied by the British Bankers Association ("BBA") that affects how consumers and companies around the world spend money, and is one of the most important benchmark interest rates in the world. Various member banks submit a daily estimate to the BBA of the rate at which they estimate they can borrow money. In the midst of the Financial Crisis, LIBOR took on new significance as a measure of bank health. The CFTC regulates futures and swaps that are priced based on benchmark rates such as LIBOR.

The CFTC brought and settled charges against ICAP for manipulation, attempted manipulation, false reporting and aiding and abetting derivatives traders' manipulation and attempted manipulation of LIBOR for Yen.[59] From at least October 2006 to at least January 2011, ICAP brokers on its Yen derivatives and cash desks "knowingly disseminated false and misleading information" concerning Yen borrowing rates in an attempt to manipulate the Yen LIBOR. One ICAP broker allegedly received a bonus partly as a reward for manipulating LIBOR. ICAP brokers also pressured derivatives traders and bank employees who made LIBOR submissions to skew them in favor of a trader at another bank.

The CFTC also brought and settled charges against Rabobank for false reporting, attempted manipulation of LIBOR for various currencies, and aiding and abetting the attempts of derivatives traders at other banks to manipulate LIBOR for various currencies.[60] From at least mid-2005

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[58] Release, Commodity Futures Trading Commission, CFTC Charges ICAP Europe Limited, a Subsidiary of ICAP plc, with Manipulation and Attempted Manipulation of Yen Libor, Rel. No. PR6708-13 (Sept. 13, 2013) http://www.cftc.gov/PressRoom/PressReleases/pr6708-13; Release, Commodity Futures Trading Commission, Rabobank to Pay $475 Million Penalty to Settle Manipulation and False Reporting Charges Related to LIBOR and Euribor, Rel. No. 6752-13 (Oct. 29, 2013), http://www.cftc.gov/PressRoom/PressReleases/pr6752-13.

[59] In the Matter of ICAP Europe Limited, Order Instituting Proceedings Pursuant to Sections 6(c) and 6(d) of the Commodity Exchange Act Making Findings And Imposing Remedial Sanctions, CFTC Docket No. 13-38 (Sept. 25, 2013), http://online.wsj.com/public/resources/documents/cftcorder0925.pdf.

[60] In the Matter of Coöperatieve Centrale Raiffeisen-Boerenleenbank B.A., Order Instituting Proceedings Pursuant To Sections 6(c) and 6(d) of the Commodity Exchange Act Making Findings And Imposing Remedial

through early 2011, Rabobank traders, some of whom also would make LIBOR submissions, accommodated their fellow trader's requests to make favorable LIBOR submissions to benefit their trading positions, making submissions described by traders as "ridiculous," "obscenely high," and "silly low." In addition to the penalty, Rabobank has to adhere to specific undertakings to ensure the integrity of its LIBOR and other benchmark submissions.

MF Global Settlement Receives Court Approval

As discussed in our 2013 Mid-Year Report, the CFTC initiated an action against MF Global Inc., its parent company MF Global Holdings Ltd. (collectively "MF Global"), its former CEO Jon Corzine, and former assistant Treasurer Edith O'Brien for both failure to segregate and misuse of customer funds. In June 2013, the CFTC entered into a settlement with MF Global. This settlement received court approval on November 8, 2013.[61] The consent order required that MF Global admit to the allegations pertaining to its wrongdoing, pay $1.212 billion in restitution to customers of MF Global Inc. to ensure customers recover the losses they sustained when MF Global failed in the fall of 2011, and pay a $100 million civil monetary penalty after MF Global has fully paid its customers and certain other creditors entitled to priority under the bankruptcy law. The CFTC's action against the other defendants is still pending.

Sanctions, CFTC Docket No. 14-02 (Oct. 29, 2013), http://www.cftc.gov/ucm/groups/public/@lrenforcementactions/documents/legalpleading/enfrabobank102913.pdf.

[61] Release, Commodity Futures Trading Commission, Federal Court in New York Orders MF Global Inc. to Pay over $1 Billion in Restitution to Customers of MF Global Inc., Rel. No. PR6776-13 (Nov. 18, 2013), http://www.cftc.gov/PressRoom/PressReleases/pr6776-13; Final Consent Order of Restitution, Civil Monetary Penalty and Ancillary Relief Against MF Global Inc., Commodity Futures Trading Comm'n v. MF Global Inc., 13-CV-04463 (S.D.N.Y. Nov. 8, 2013), http://www.cftc.gov/ucm/groups/public/@lrenforcementactions/documents/enforcementaction/enfmfglobalorder110813.pdf.

VII. Recent SEC Policy and Regulatory Developments

Enhanced Reporting and Auditing Standards for Broker-Dealers

On July 31, 2013, the SEC voted to increase reporting requirements of broker-dealers to further protect customers by a 3-2 vote. These rules were primarily designed to enhance accounting requirements already imposed on broker-dealers through the Net Capital Rule, Customer Protection Rule, Quarterly Security Count Rule and self-regulatory organization ("SRO") rules that require the issuance of statements at least quarterly.[62]

The SEC has distinguished between the requirements it imposes on broker-dealers that maintain custody of customer assets and those that do not. Broker-dealers that maintain custody of client assets must file a "compliance report" with the SEC that verifies adherence to capital requirements to protect customer assets. A broker-dealer that does not maintain custody of customer assets must file a report stating as much, referred to as an "exemption report." Both firms that file compliance reports and firms that file exemption reports with the SEC must engage a Public Company Accounting Oversight Board ("PCAOB") registered independent accounting firm to prepare a report based on statements contained in the SEC report.

[62] Release, U.S. Securities and Exchange Commission, SEC Adopts Rule to Increase Protections for Investors With Assets Being Held By Broker-Dealers, Rel. No. 2013-141 (July 31, 2013), http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370539740621.

Additionally, these reviews must comport to PCAOB standards rather than the Generally Accepted Accounting Standards that were previously required.

Under the new rules, all registered broker-dealers are required to file a new quarterly report with the SEC, referred to as the Form Custody report. This report will detail the means by which a broker-dealer maintains customer cash and securities. The amendments also require that all broker-dealers permit SEC and SRO staff to inspect all independent accounting documentation and work papers, provided such a request is made in writing. This inspection requirement pertains to both firms that maintain customer assets and those that do not.

SEC Clarification of Requirements Originally Imposed by Regulation SHO

On August 9, 2013, the SEC posted a risk alert to clarify Regulation SHO's restrictions on short selling.[63] Regulation SHO requires that a short seller have a reasonable belief that it can borrow and deliver before the sale occurs. Regulation SHO further provides that if the security cannot be located, then the participant (excluding bona fide market makers) must close out its position in that security no later than the third business day after the settlement date. This closeout can be achieved by "borrowing or purchasing securities of a like kind and quantity."

The SEC itemized numerous practices that it deemed to be attempts to evade this closeout requirement. As OCIE Director Andrew Borden noted, this non-exhaustive list should "help broker-dealers and their correspondent clearing firms avoid the regulatory and reputational risks that are posed by these activities."

Chair White Spearheads Efficiency and Functionality Reforms With Industry Leaders

In the wake of the three hour paralysis of NASDAQ on August 22, 2013, Chair Mary Jo White called for a meeting with the leaders of equities and options exchanges, FINRA, Depository Trust Clearing Corporation and the Options Clearing Corporation. The purpose of the meeting was to emphasize that an efficient and functional market system

[63] Release, U.S. Securities and Exchange Commission, SEC Issues Risk Alert On Options Trading Used To Evade Short-Sale Requirements, Rel. No. 2013-151 (Aug. 9, 2013), http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370539762224.

can only be achieved with cooperation and collaboration. To this end, Chair White instructed that each attendee work together to ensure that the market systems continue to work together for the good of the investing public.[64]

Chair White identified certain next steps that the industry leaders should examine to avoid similar interruptions in the future, including:

- Market participants must submit detailed action plans to lay a ground work of what should be included in reliable securities information processors and other critical infrastructure systems testing and reporting;

- Market participants should develop plans to effectively address issuance, effectiveness, and communication of regulatory halts;

- Market participants should endeavor to review trade breaks as well as procedure to re-open trading after a halt has been lifted; and

- Exchanges should have the ability to use a kill switch to cease trading in the event of technological failure.

In furtherance of this meeting, on November 12, 2013, FINRA announced that the SROs, working in conjunction with the SEC, had come to a general agreement on certain recommendations and preliminary implementation timetables that would be presented in subsequent rule filings subject to public comment and SEC approval.[65]

SEC Introduces Enhanced Website to Increase Investor Access to Information

On October 9, 2013, the SEC published its Market Information Data Analytics System ("MIDAS") on its website, to grant real-time access to comparative analytics, research and metrics that were previously only available to sophisticated market participants.

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[64] Release, U.S. Securities and Exchange Commission, SEC Chair White Statement on Meeting with Leaders of Exchanges, Rel. No. 2013-178 (Sept. 12, 2013), http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370539804861.

[65] Release, FINRA Self-Regulatory Organization Response to SEC for Strengthening Critical market Infrastructure (November 12, 2013), http://www.finra.org/Newsroom/NewsReleases/2013/P383597.

Through MIDAS, the SEC hopes to share "the data and related observations [to] address the nature and quality of displayed liquidity across the full range of U.S.-listed equities from the lifetime of quotes and the speed of the market to the nature of cancellations."[66] MIDAS is one of the SEC's "wide-ranging effort[s] to seek out better sources of data to better assess today's complex markets."[67] Other efforts include the Consolidated Audit Trail and cooperation with initiatives of other domestic and foreign regulators to analyze equity trading in a broader sense.

FINRA's Report on Conflict of Interest

FINRA published a report in October 2013 that sought to identify best practices that they had observed at member firms concerning conflict of interest procedures. While the guidance in the report is merely precatory, FINRA warned that, "if firms do not make adequate progress on conflicts management, FINRA will evaluate whether rulemaking to require reasonable policies to identify, manage and mitigate conflicts would enhance investor protection."[68] FINRA identified three areas on which firms would need to focus: (i) enterprise level frame works to identify and manage conflicts of interest; (ii) approaches to handling conflicts of interest inherent in the development and marketing new financial products; and (iii) compensation related practices.

First, the report recommended that firms establish a structure in which they can identify and effectively manage conflicts of interest through "underlying ethics culture, organizational structures, policies, processes, and incentive structures." FINRA observed that a number of firms established a top down approach to conflict of interest management, which includes elevated ethics and a customer first approach.

Second, the report recognized that while strong frameworks are essential to a responsible firm policy, new products could indeed raise new areas of conflict that need to be

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[66] Release, U.S. Securities and Exchange Commission, SEC Launches Market Structure Data and Analysis Website, Rel. No. 2013-217 (Oct. 9, 2013), http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370539865877.

[67] Speech, Focusing on the Fundamentals: The Path to Address Equity Market Structure, Delivered by SEC Chair Mary Jo White, before the Security Traders Association 80th Annual Market Structure Conference (Oct. 2, 2013), http://www.sec.gov/News/Speech/Detail/Speech/1370539857459.

[68] See FINRA Report on Conflicts of Interest (Oct. 2013), http://www.finra.org/web/groups/industry/@ip/@reg/@guide/documents/industry/p359971.pdf.

addressed. Firms can effectively detect and mitigate these potential conflicts of interest through a thorough and open review process both before and after the launch of a new financial product. To this end, firms should review products for potential conflicts, openly report such conflicts, avoid potentially conflicted distribution channels, and further review the product in question once it has been offered to the marketplace.

Third, the report cautioned firms about structuring registered representatives' compensation in a way that could undermine that representative's investment recommendations. FINRA observed that certain firms practice neutral compensation structures that eliminate differences in broker compensation among products to create less incentive to endorse certain products. Additionally, FINRA recognized that "supervision and surveillance" of registered representatives and their recommendations is particularly important as they reach potential compensation thresholds to avoid prohibited practices such as churning. FINRA advocates that firms pay particular attention to registered representatives' activities as clients approach important milestones in their investment life, such as retirement or 401(k) rollovers.

Volcker Rule

On December 10, 2013, the final rule implementing the provision of the Dodd-Frank Act, commonly known as the Volcker Rule, was adopted by the Federal Reserve Board, the CFTC, the FDIC, the OCC, and the SEC.[69] The Volcker Rule generally consists of three major components: (i) the proprietary trading prohibition, (ii) the covered funds prohibition and (iii) compliance requirements.

Proprietary Trading. The Volcker Rule prohibits insured depository institutions and their affiliates ("banking entities") from engaging in propriety trading, unless they are subject to one of its exemptions including, among others, underwriting activities, market-making, risk-mitigating hedging, trading in certain government obligations, and certain trading activities of foreign banking entities.

For example, proprietary trading is allowed if a banking entity acts as an underwriter when distributing securities where its underwriting position is related to that distribution and the institution's position does not exceed the

[69] 12 U.S.C. § 1851.

reasonably expected near-term demands of its customers. Similarly, market-making activities are allowed so long as the trading desk's inventory in financial instruments does not exceed the reasonably expected near-term demands of its customers. Customer demands are based on among others things historical demand and certain market factors. Hedging is also allowed, however, a hedge must demonstrably reduce or significantly mitigate specific identifiable risks.

The proprietary trading prohibition will likely be subject to regulatory interpretation based on these broad exemptions. In particular, the permissibility of a trade depends on the facts and circumstances in which it is made and whether a banking entity is able to show that it had reasonable expectations that it could meet the expected near-term needs of its customers.

Covered Funds*.* Under the Volcker Rule, banking entities are prohibited from owning and sponsoring hedge funds and private equity funds known as "covered funds." A covered fund is defined as any issuer that would be considered an investment company under the Investment Company Act, if it is not already excluded by Sections 3(c)(1) or 3(c)(7), or certain foreign funds and commodity pools. As an exception to this prohibition, banking entities are permitted to invest in or sponsor a covered fund in connection with the organization and offering of the fund, underwriting or market-making activities, certain types of risk-mitigation hedging, foreign activities, and insurance company activities.

Compliance*.* Banking entities will be required to employ compliance procedures based on their respective size and complexity. Generally, banking entities will need to establish internal compliance programs that are designed to ensure and monitor compliance with the Volcker Rule, including employing written policies and procedures dealing with trading activity, committing adequate resources to oversee and independently test the program, and implementing internal controls. Larger banking entities will have to establish a more robust program, including a CEO attestation.

Effective Date. The Volcker Rule will become effective on April 1, 2014. The Federal Reserve Board has extended the conformance period until July 21, 2015. Reporting requirements will roll out based on the size of the financial institution. Banking entities with $50 billion or more in consolidated trading assets and liabilities will be required to report quantitative measurements by June 30, 2014. Banking entitles with between $25–50 billion in consolidated trading assets and liabilities become subject to report on April 30, 2016. Finally, financial entitles with between $10-25 billion in consolidated trading assets and liabilities become subject to these requirements on December 31, 2016. Community banks with $10 billion or less in consolidated trading assets and liabilities will not have any compliance obligations.

VIII. SEC Cooperation Program

The last half of 2013 witnessed the ongoing development and implementation of the SEC's Cooperation Program. During this time, the SEC credited companies and individuals for their cooperation in many cases, including the following:

- A declination to bring an enforcement action against First Solar Inc. in connection with alleged Regulation FD violations by its former head of investor relations ("First Solar Declination");

- A Report of Investigation pursuant to Section 21(a) of the Securities Exchange Act of 1934 in connection with Eurex Deutschland allegedly offering and selling futures without complying with applicable federal securities registration requirements ("Eurex 21(a) Report");

- A DPA with Scott Jonathan Herckis for aiding and abetting the misappropriation of hedge fund assets ("Herckis DPA"); and

- A settled civil case against Archer Daniels Midland Company for failing to prevent illicit payments made by foreign subsidiaries to Ukrainian government officials in violation of the Foreign Corrupt Practices Act ("ADM Settlement").

These cases offer significant insight into the framework in which the SEC analyzes and rewards cooperation, including how Chair Mary Jo White's new policy with respect to seeking admissions under certain circumstances[70] (as discussed in our previous Executive Alert) affects the SEC's continued implementation of its Cooperation Program. Also, while many companies and individuals appear to receive a reduction in civil penalties as a reward for cooperating with the SEC,[71] these cases show that cooperation under certain facts and circumstances may also help companies or individuals avoid enforcement actions altogether.

First Solar Declination[72]

In September 2013, the SEC announced the settlement of charges against First Solar's former head of investor relations for alleged Regulation FD violations relating to selective disclosure of material non-public information relating to First Solar. In connection with the settlement, the SEC also announced that it declined to pursue an enforcement action against First Solar "due to the company's extraordinary cooperation with the investigation among several other factors."

In particular, the SEC noted that, prior to the alleged selective disclosure, "First Solar cultivated an environment of compliance through the use of a disclosure committee that focused on compliance with Regulation FD." The SEC

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[70] Speech, Deploying the Full Enforcement Arsenal, Delivered by SEC Chair Mary Jo White before the Council of Institutional Investors (Sept. 26, 2013), http://www.sec.gov/News/Speech/Detail/Speech/1370539841202#.UomizRb9E9U.

[71] *See, e.g.*, *In the Matter of Knight Capital Americas LLC,* Exchange Act Rel. No. 70694, Order Instituting Administrative and Cease-and-Desist Proceedings, Pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing Remedial Sanctions and a Cease-And-Desist Order (Oct. 16, 2013) (consent order without admitting or denying the findings therein imposing, among other things, a civil penalty of $12,000,000 where alleged Regulation SHO violations caused an approximate $460,000,000 loss), http://www.sec.gov/litigation/admin/2013/34-70694.pdf; *In the Matter of ABN AMRO Bank, N.V.*, Exchange Act Rel. No. 70086, Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Section 8A of the Securities Act of 1933, Sections 15(b) and 21C of the Securities Exchange Act of 1934, and Sections 203(e) and 203(k) of the Investment Advisers Act of 1940, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order (July 31, 2013) (consent order without admitting or denying the findings therein imposing, among other things, disgorgement of $2,943,408, prejudgment interest of $604,000, and a civil penalty of $2,000,000), http://www.sec.gov/litigation/admin/2013/33-9437.pdf.

[72] Release, U.S. Securities and Exchange Commission, SEC Charges Former Vice President of Investor Relations With Violating Fair Disclosure Rules, Rel. No. 2013-174 (Sept. 6, 2013), http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370539799034.

also noted that First Solar "quickly self-reported the misconduct" and "undertook remedial measures to address the improper conduct" by "promptly issu[ing] a press release the next morning before the market opened" and "conduct[ing] additional Regulation FD training for employees responsible for public disclosure."

In this respect, First Solar satisfied all the cooperation factors listed in the SEC's Enforcement Manual by self-policing, self-reporting, remediating, and cooperating.[73] And like the Morgan Stanley declination announced in April 2012,[74] the First Solar declination exhibits how a company's actions taken before the company becomes aware of misconduct (in particular, a reasonably tailored compliance program) may help it avoid an enforcement action.

Eurex 21(a) Report[75]

In August 2013, the SEC for the first time since implementing the Cooperation Program provided cooperation credit in the form of a 21(a) report, which surprisingly is not listed as a cooperation tool in the SEC's Enforcement Manual.[76]

According to the 21(a) Report (to which Eurex consented without admitting or denying its contents), Eurex is a foreign derivatives exchange that offered and sold futures to U.S. customers on what was initially a broad-based index not subject to the registration requirements of the federal securities laws. Because Eurex did not have any policies and procedures at the time to monitor compliance with this exemption, it failed to discover for a period of approximately 18 months that the index had become a narrow-based security index without a valid exemption from the securities laws in violation of Sections 5 and 6(h)(1) of the Exchange Act.

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[73] *SEC Enforcement Manual* at 121-22 (Oct. 4, 2013) (hereinafter *Enforcement Manual*), http://www.sec.gov/divisions/enforce/enforcementmanual.pdf.

[74] Release, U.S. Securities and Exchange Commission, SEC Charges Former Morgan Stanley Executive with FCPA Violations and Investment Adviser Fraud, Rel. No. 2012-78 (Apr. 25, 2012), http://www.sec.gov/News/PressRelease/Detail/PressRelease/1365171488702.

[75] Release, U.S. Securities and Exchange Commission, Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934: Eurex Deutschland, Rel. No. 70148 (Aug. 8, 2013), http://www.sec.gov/litigation/investreport/34-70148.pdf.

[76] *Enforcement Manual* at 122.

Instead of pursuing an enforcement action against Eurex, the SEC decided to issue the 21(a) Report to "caution exchanges and investment professionals to monitor the composition of indices used in offering financial instruments to determine if they are security futures products and ensure they are complying with the federal securities laws." In particular, the SEC opted not to pursue an enforcement action against Eurex because it provided the SEC with "substantial and timely cooperation" (including self-reporting the findings of its review and voluntarily providing updates and documents) and undertook "prompt remediation efforts" (including implementing "comprehensive policies and procedures that now require monthly, and in some instances daily, compliance monitoring of indices on which it offers futures contracts in the U.S."). The Eurex 21(a) Report also noted that "[i]mmediately on discovering the issue, Eurex ceased offering and selling the security futures on the Index in the United States and sent a notice informing Eurex members of the change in status of the futures on the Index."

In this respect, Eurex's cooperation was substantial because it satisfied three of the four cooperation factors listed in the SEC's Enforcement Manual by self-reporting, remediating, and cooperating. The Eurex 21(a) Report is significant because it shows the SEC's continued willingness to forego an enforcement action where a company substantially cooperated and undertook appropriate remedial measures. However, its application to future cases may be limited based on the fact that the SEC may have viewed it as a "message" case to clarify certain risks that the financial industry had previously overlooked.

Herckis DPA[77]

In November 2013, the SEC entered into its first-ever DPA with an individual—a former hedge fund administrator who aided and abetted the misappropriation of fund assets.

According to the DPA, from December 2010 to September 2012, Herckis transferred money from the hedge fund to its manager whenever the manager instructed, even though the fund was prohibited from making loans to the manager and commingling fund assets with assets from any other source. These transfers resulted in a negative balance in

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[77] Deferred Prosecution Agreement between Scott Jonathan Herckis and the U.S. Securities and Exchange Commission (Nov. 8, 2013), http://www.sec.gov/news/press/2013/2013-241-dpa.pdf.

the fund's capital account and the misappropriation of approximately $1.5 million from the fund. Herckis also materially overstated the monthly account statements he provided to investors and the rate of return information he provided to potential investors.

In September 2012, Herckis resigned as fund administrator, contacted government authorities and voluntarily provided immediate and complete cooperation in the resulting SEC investigation, including producing voluminous documents and helping the SEC understand how the manager perpetrated the fraud. As a result of Herckis's cooperation, the SEC was able to file an emergency action to freeze approximately $6 million in assets, which subject to court approval, will be distributed to the fund's investors.

The Herckis DPA includes all the customary provisions described in the SEC's Enforcement Manual.[78] Prior to it, the SEC had entered into two DPAs with entities—one with Tenaris S.A. for books and records violations of the FCPA[79] and the other with the Amish Helping Fund for material misrepresentations in its offering materials.[80]

These three DPAs are similar in many respects. In particular, like the Tenaris and AHF DPAs, Herckis was required to, among other things; (i) admit certain facts of wrongdoing; (ii) cooperate with the SEC; and (iii) refrain from violating the federal and state securities laws and

[78] *Enforcement Manual* at 127-28 ("A deferred prosecution agreement is a written agreement between the Commission and a potential cooperating individual or company in which the Commission agrees to forego an enforcement action against the individual or company if the individual or company agrees to, among other things: 1) cooperate truthfully and fully in the Commission's investigation and related enforcement actions; 2) enter into a long-term tolling agreement; 3) comply with express prohibitions and/or undertakings during a period of deferred prosecution; and 4) under certain circumstances, agree either to admit or not to contest underlying facts that the Commission could assert to establish a violation of the federal securities laws. If the agreement is violated during the period of deferred prosecution, the staff may recommend an enforcement action to the Commission against the individual or company without limitation for the original misconduct as well as any additional misconduct. Furthermore, if the Commission authorizes the enforcement action, the staff may use any factual admissions made by the cooperating individual or company to file a motion for summary judgment, while maintaining the ability to bring an enforcement action for any additional misconduct at a later date.").

[79] Deferred Prosecution Agreement between Tenaris S.A. and the U.S. Securities and Exchange Commission (May 17, 2011), http://www.sec.gov/news/press/2011/2011-112-dpa.pdf.

[80] Deferred Prosecution Agreement between the Amish Helping Fund and the U.S. Securities and Exchange Commission (July 17, 2012), http://www.sec.gov/news/press/2012/2012-138-dpa.pdf.

making any statements inconsistent with the DPA. Herckis also was not required to pay a civil penalty.

Despite these similarities, the Herckis DPA is different from the Tenaris and AHF DPAs in two material respects. First, the Herckis DPA has a maximum term of five years,[81] whereas the Tenaris and AHF DPAs have two-year terms. Second, the Herckis DPA bars him from associating with nearly all securities industry participants, whereas the Tenaris and AHF DPAs do not include any such bar or similar prohibition. This last difference is particularly significant because the bar effectively forces Herckis out of the securities industry for five years, whereas Tenaris and AHF are allowed to continue each of their businesses pursuant to certain restrictions and undertakings.

In announcing the Herckis DPA, the SEC's Associate Director of Enforcement Scott W. Friestad recognized that "most useful cooperators [like Herckis] often aren't innocent bystanders" and that the DPA balances the competing interests of "rewarding proactive cooperation" and "hold[ing] Herckis accountable for his misconduct."[82]

The Herckis DPA is indeed a significant development because it seems to illustrate how Chair White's new policy of seeking admissions under certain circumstances affects the implementation of the SEC's Cooperation Program. In particular, the terms of other recent settlements with individual cooperators[83] suggest that, if the settlement occurred prior to this new policy, it likely would have been pursuant to a consent order or judgment with no admission

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[81] *Enforcement Manual* at 129 ("The term of a deferred prosecution agreement should not exceed five years. In determining the appropriate term, the staff should consider whether there is sufficient time to ensure that the undertakings in the agreement are fully implemented and the related prohibitions have adequately reduced the likelihood of future securities law violations.").

[82] Release, U.S. Securities and Exchange Commission, SEC Announces First Deferred Prosecution Agreement With Individual, Rel. No. 2013-241 (Nov. 12, 2013), http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370540345373.

[83] Release, U.S. Securities and Exchange Commission, SEC Charges Husband and Wife in Florida with Defrauding Seniors Investing in Purported Charity, Rel. No. 2013-19 (Feb. 4, 2013), http://www.sec.gov/News/PressRelease/Detail/PressRelease/1365171512714#.Uomk2Bb9E9V; Release, U.S. Securities and Exchange Commission, *SEC v. Aamer Abdullah*, Rel. No. 22527 (Nov. 9, 2012), http://www.sec.gov/litigation/litreleases/2012/lr22527.htm; Release, U.S. Securities and Exchange Commission, *SEC Charges Three in North Carolina With Insider Trading*, Rel. No. 2012, 193 (Sept. 20, 2012), http://www.sec.gov/News/PressRelease/Detail/PressRelease/1365171484866#.Uomm0Bb9E9U.

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of wrongdoing. Given this development, the Herckis DPA may foreshadow a change going forward in SEC settlements with individual cooperators, including gatekeepers and fiduciaries like Herckis who blew the whistle with unclean hands.[84]

ADM Settlement[85]

In December 2013, the SEC announced the filing of a settled civil action against ADM for violating the books and records and internal controls provisions of the FCPA by failing to prevent certain of its foreign subsidiaries from bribing Ukrainian government officials through intermediaries to make approximately $33 million in illegal profits through illicit tax refunds from approximately 2002 to 2008. These payments were concealed by improperly recording them as insurance premiums and other purported business expenses.

In reaching the settlement, the SEC noted that it took into account "ADM's cooperation and significant remedial measures, including self-reporting the matter, implementing a comprehensive new compliance program throughout its operations, and terminating employees involved in the misconduct." According to the complaint, ADM also "immediately retained outside counsel to conduct an internal investigation", "voluntarily conducted a world-wide risk assessment and corresponding global internal investigation, made numerous presentations to the Department of Justice and the Securities and Exchange Commission, made current and former employees available for interviews, produced documents without subpoena, and implemented early and extensive remedial measures."

Based on its cooperation, ADM apparently avoided a civil penalty. Instead, the SEC only sought a final judgment ordering ADM to pay disgorgement of $33,342,012 and prejudgment interest of $3,125,354, to be permanently enjoined from violating the books and records and internal

[84] *Enforcement Manual* at 128 ("An admission or an agreement not to context the relevant facts underlying the alleged offenses generally is appropriate and should be carefully considered for the following: licensed individuals, such as attorneys and accountants; regulated individuals, such as registered brokers or dealers; fiduciaries for other individuals or entities regarding financial matters; officers and directors of public companies; and individuals or companies with a prior history of violating the securities laws.")

[85] Release, U.S. Securities and Exchange Commission, SEC Charges Archer-Daniels-Midland Company With FCPA Violations, Rel. No. 2013-271 (Dec. 20, 2013), http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370540535139.

controls provisions of the FCPA and to report on its FCPA compliance efforts for a three-year period.

Unlike the Ralph Lauren Corporation non-prosecution agreement (discussed in our Mid-Year Report),[86] it appeared that ADM was unable to avoid an enforcement action because the scope of its FCPA violations (in terms of the time period in which they occurred, the amount of money involved and the extent of the company operations involved) far exceeded the scope of Ralph Lauren's FCPA violations. Also unlike the Ralph Lauren NPA (in which Ralph Lauren neither admitted nor denied liability for the factual allegations therein), ADM's settlement does not contain a no-admit, no-deny provision (the absence of which is consistent with ADM's contemporaneous NPA with the DOJ in which ADM admitted that it failed to have adequate internal controls to prevent bribery in Ukraine).

[86] Release, U.S. Securities and Exchange Commission, SEC Announces Non-Prosecution Agreement With Ralph Lauren Corporation Involving FCPA Misconduct, Rel. No. 2013-65 (Apr. 22, 2013), http://www.sec.gov/News/PressRelease/Detail/PressRelease/1365171514780.

VIII. BakerHostetler Securities Litigation and Regulatory Enforcement Contacts

National Contact		
Marc D. Powers	212.589.4216	mpowers@bakerlaw.com
Chicago		
William K. Kane	312.416.6211	wkane@bakerlaw.com
Cincinnati		
Ted T. Martin	513.929.3416	tmartin@bakerlaw.com
Cleveland		
Edmund W. Searby	216.861.7689	esearby@bakerlaw.com
Columbus		
Thomas L. Long	614.462.2626	tlong@bakerlaw.com
Costa Mesa		
George Mooradian	714.966.8800	gmooradian@bakerlaw.com
Denver		
Richard B. Levin	303.764.4010	rlevin@bakerlaw.com
Houston		
Paul S. Francis	713.646.1334	pfrancis@bakerlaw.com
Los Angeles		
Michael R. Matthias	310.442.8802	mmatthias@bakerlaw.com
New York		
Mark A. Kornfeld	212.589.4652	mkornfeld@bakerlaw.com
Andrew W. Reich	212.589.4222	areich@bakerlaw.com
Jimmy Fokas	212.589.4272	jfokas@bakerlaw.com
John W. Moscow	212.589.4636	jmoscow@bakerlaw.com
Orlando		
Jerry R. Linscott	407.649.4024	jlinscott@bakerlaw.com
Washington, DC		
Michael G. Oxley	202.861.1663	moxley@bakerlaw.com
Jonathan R. Barr	202.861.1534	jbarr@bakerlaw.com

Atlanta Chicago Cincinnati Cleveland Columbus Costa Mesa
Denver Houston Los Angeles New York Orlando
Philadelphia Seattle Washington, DC

www.bakerlaw.com