Contents

Acknowledgments  xiii
Preface  xv

Chapter 1  Overview: The Multilayered Securities Enforcement System  1
A. Introduction  3
B. SEC Enforcement  7
C. Self-Regulatory Organizations  8
D. State Regulation  9
E. Criminal Prosecution  11

Chapter 2  Inspections of Broker-Dealers, Investment Advisers and Other Regulated Firms  13
A. Introduction  15
B. OCIE and the Inspection Program  17
C. The Inspection Process  19
   1. Selection of Inspection Targets  19
   2. Conduct of the Inspection  20
   3. The Inspection Outcomes  21
D. Handling the Inspection  23
   1. The Essential Prerequisite: An Effective Compliance Program  23
   2. Managing the Process  25
   3. Relating to the Examiners  27
   4. The Importance of Candor  28
   5. Maintaining Confidentiality  28
E. The Limits of the SEC’s Inspection Powers  29
F. The Current State Of The SEC’s Inspection Program  32

Chapter 3  SEC Investigations  35
A. The Importance of SEC Investigations  39
B. The Commission’s Authority to Conduct Investigations  42
C. The Initiation of SEC Investigations  44
D. The Various Types of SEC Investigations  46
   1. Inspections of Regulated Firms  46
   2. Preliminary Inquiries  46
   3. Informal Investigations  47
   4. Formal Investigations  49
E. Cooperation and Remediation in Enforcement Investigations  52
   1. The Seaboard Report  52
   2. What Is Cooperation?  56
   3. Potential Benefits of Cooperation and Remediation  57
   4. Increased Sanctions for Lack of Cooperation  60
N. Wells Submissions: The Critical Step at an Investigation's Conclusion 165
1. The Historical Background of Wells Submissions 167
2. Pre-Wells Submissions and Meetings 168
3. The Wells Submission Process 169
4. The Determination Whether to File a Wells Submission 171
5. The Wells Submission's Role in the Settlement Process 172
6. Preparation of a Wells Submission 173
7. Filing a Wells Submission and the Staff’s Reply 177
8. The Post-Wells Process 177
9. The Use of Wells Submissions in Subsequent Actions 178

Chapter 4 Sanctions and Collateral Consequences 181
A. Overview of the SEC's Civil Enforcement Powers 183
B. Injunctions 186
C. Cease and Desist Orders—The Alternative Route 188
D. Monetary Penalties 194
1. The Remedies Act 194
2. Heightened Penalties and the Use of “Fair Funds” 197
3. The SEC’s Policy Statement Regarding Corporate Penalties 198
4. Insider Trading Penalties 201
E. Disgorgement 203
F. Fair Funds and Disgorgement Distribution Plans 207
G. Bar Against Serving as an Officer or Director 210
1. The “Unfitness” Standard 212
2. Time Limited and Conditional Bars 215
3. Equitable Officer and Director Bars 216
H. Ancillary Relief in Injunctive Proceedings 217
I. Undertakings 219
J. Temporary Freezes of Extraordinary Payments to Corporate Officers and Employees 223
K. Sanctions against Regulated Entities and Their Associated Persons 226
1. Revocation or Bar 227
2. Suspensions 229
3. Censure 230
4. Limitations on Activities 230
L. Collateral Consequences of Injunctive and Administrative Cease and Desist Orders 231
1. Disclosure and Reporting Obligations 232
2. Safe Harbor for Forward-Looking Statements 235
3. Offering Exemptions 236
4. Additional Collateral Consequences Specific to Regulated Entities and Their Associated Persons 238
5. Impact in Private Litigation 242
6. Proceedings by Foreign Regulators 244
M. Persons in the Commodity Futures Industry 245
N. Professionals 245
Chapter 5  

Settlements  255

A. The Decision to Settle or Litigate  257

B. The Potential Advantages of Settling  259
1. Limiting Adverse Publicity  260
2. Eliminating Individual Defendants  260
3. Negotiating Lesser Charges  260
4. Avoiding Collateral Estoppel  261
5. Resolving Uncertainties in Securities Industry Status  261
6. Threat of Criminal Prosecution  262

C. The Settlement Process  263

D. The Timing of Settlement Discussions  265

E. Negotiating the Type of Commission Action  268
1. The Alternatives  268
2. Negotiating an Administrative Cease and Desist Order in Lieu of an Injunction  269
3. Settling an Injunctive Action  270

F. Negotiating the Settlement Documents  272

G. Negotiating the Ancillary Remedies  274
1. Disgorgement  274
2. Monetary Penalties  275
3. Bar against Serving as an Officer or Director  277
4. Other Settlement Remedies  278

Chapter 6  

Litigating SEC Injunctive Actions  281

A. Introduction  283

B. The Commission’s Requests for Preliminary or Emergency Relief  285
1. Preliminary Injunctions and Restraining Orders  285
2. Asset Freezes and Receivers  388
3. Responses to Motions for Preliminary Relief  289

C. The Defendant’s Response to the Commission’s Complaint  291
1. Preliminary Defense Motions  291
2. Answers and Affirmative Defenses  299
3. Discovery  310
4. The Right to a Jury Trial  313
5. Burden of Proof  314

D. The Permanent Injunction  315

E. Post-Judgment Remedies: Strategies for Modifying or Vacating an Injunction  319

Chapter 7  

Litigating Administrative Proceedings  321

A. Introduction  323

B. Overview of the Role of Administrative Proceedings in SEC Enforcement  323
1. Types of Proceedings and the Process  323
2. Legislative History  324
3. Differences from Civil Actions  325
Chapter 8  Criminal Enforcement of Securities Laws  391

A.  Overview  393

B.  Federal Criminal Prosecution in Securities Cases:
The Current Environment  395
1.  Major Corporate Fraud Cases  395
2.  DOJ’s Corporate Fraud Task Force  397
3.  The Sarbanes-Oxley Act of 2002  397
4.  SEC/DOJ Coordination: Parallel Proceedings  400
5.  Assessing the Potential for Criminal Prosecution  407

C.  Fundamental Criminal Principles and
Their Application to Corporate Crime  410
1.  General Criminal Principles  410
2.  Scienter Requirements in Securities Cases  414
3.  Criminal Liability and Rights of Corporations  416
4.  Prosecutorial Discretion and DOJ’s Principles of Federal
Prosecution of Business Organizations  421
Contents

D. Introduction to Criminal Prosecution 430
   1. Overview of DOJ Investigations and the Criminal Process 430
   2. The Criminal Process 431
   3. Role of the Grand Jury 442
   4. Cooperation by a Corporation: Internal Investigations and Self-Reporting 446
   5. Preservation of Evidence 447

E. Major Criminal Offenses and Offenses Related to the Criminal Process 450
   1. Conspiracy 451
   2. Aiding and Abetting 455
   3. Mail and Wire Fraud 457
   4. Money Laundering 460
   5. Foreign Corrupt Practices Act 463
   6. Racketeer Influenced and Corrupt Organizations Act ("RICO") 464
   7. Process Criminal Offenses 465

Chapter 9 Enforcement by Self-Regulatory Organizations 473
A. Introduction 475
   1. Overview 475
   2. The NASD and the NYSE 476

B. The Source and Scope of SRO Disciplinary Authority 479

C. SRO Disciplinary Jurisdiction 481
   1. Disciplinary Jurisdiction 481
   2. Retention of Jurisdiction by the SROs 481

D. Sources and Topics of SRO Investigations 482

E. SRO Investigations 483
   1. In General 483
   2. Commencement of Investigation 484
   3. Simultaneous Investigations of the Same Matter 485
   4. Confidentiality 485
   5. Representation by Counsel 486
   6. Duty to Cooperate 486
   7. Fifth Amendment Protections 488
   8. Document Production 490
   9. Witness Statements 492
   10. Interviews and Testimony 492

F. Conclusion of the Investigation 493
   2. Wells Calls and Wells Submissions 494
   3. SRO Settlements 495

G. Contested Hearings 500
   1. Statutory Requirements and Overview of Disciplinary Rules 500
   2. Complaints, Charge Memoranda, Answers, and Hearing Panels 501
   3. Discovery 504
4. Pre-Hearing Procedures and Motions 505
5. Hearings 506
6. Decisions and Sanctions 507
7. Internal SRO Appeals 511
H. SEC Review of SRO Decisions 512
1. SEC Authority 512
2. The SEC Review Process 515
3. Strategic Considerations 516
I. Judicial Review of SEC Decisions 517

Chapter 10 Blue Sky Enforcement  521
A. Introduction 523
B. Special Challenges in State Enforcement Practice 524
C. State Securities Regulators: Who They Are and How They Are Organized 526
1. Individual State Regulators 526
2. The Role of NASAA 527
D. The Powers of State Securities Regulators 529
1. Statutory Authority 529
2. General Investigatory Procedures 532
3. Sanctions 533
E. Defending a State Securities Investigation 538
1. Initiation of a State Investigation 538
2. The Role of Counsel 538
3. The Investigative Record 539
4. Resolving a State Securities Investigation 543
F. Dealing with Multistate Investigations 544
G. The Rise in Coordinated Federal, State and SRO Investigations 547
H. Litigating an Enforcement Action 548
1. Administrative Hearings 549
2. Civil Proceedings 550
3. Criminal Proceedings 551
I. Collateral Consequences of State Enforcement Actions 552

Chapter 11 Common Ethical Sanctions and Representation Issues in the Securities Enforcement Process  555
A. Introduction 557
B. Sources of Authority 559
C. Issues Arising from Counsel’s Prior Involvement in Matters under Investigation 560
1. The Lawyer as Witness 562
2. The Lawyer as “Subject” or “Target” 564
D. Joint Representation 568
1. Advantages of a Joint Representation 568
2. Conflicts in Joint Representations 570
3. Consequences of Joint Representation 572
4. Common Situations in Joint Representation That Raise Conflict Issues 575
Chapter 12 An Overview of Enforcement of the Financial Services Authority 597

A. The FSA Regulatory Regime 601
   1. General 601
   2. The FSA's Role and Statutory Powers 602
   3. FSA Authorization and Approval 606
   4. FSA Enforcement 607
   5. Major Differences from the U.S. Regimes 609

B. Recent Developments 611
   1. The Enforcement Process Review 611
   2. The Shift to a Principles-Based Approach 612
   3. Handbook Changes 613

C. The FSA's Supervisory Activity 613
   1. Supervision/ARROW Visits/Inspection of Regulated Entities 613

D. The Initiation of FSA Investigations 617
   1. Reference to Enforcement Division/Use of Formal Powers 617

E. The Various Types of FSA Inquiries/Investigations 619
   2. The Responsibility to Self-Report—Specific Rules 621
   3. The Responsibility to Self-Report—the Notification-Timing and Content 625
   4. Money Laundering Reporting Obligations and Suspicious Transaction Reports 626
   5. Statutory Information Requests to Authorized Persons under the Section 165 Power 627
   6. Skilled Person's Reports 628
   7. Formal Investigations 629
   8. Remedial Action 633

F. Cooperation and Remediation in Enforcement Investigations 634
   1. The “Regulatory Dividend” 634
   2. Cooperation and Legal Representation Issues 635
   3. Remediation 635

G. Responding to Information Requirements/Investigations 636
   1. Legal Professional Privilege and “Protected Items” 636
   2. Privilege against Self-incrimination—Use of Information Obtained under Compulsion 637
   3. Challenges to FSA Information Requirements 639
   4. Confidentiality—Obligations owed by the Firm 639
   5. Confidentiality—The FSA's Position 639
   6. Document Production 642
Contents

C. Other Coverages 719
   1. Errors and Omissions Coverage 719
   2. Excess Side A / Side A Only Coverage 719

Index 000

About the Author 721