

DELVACCA CHAPTER, ASSOCIATION OF CORPORATE COUNSEL
3RD ANNUAL IN-HOUSE COUNSEL CONFERENCE

ASSOCIATION OF CORPORATE COUNSEL

DELVACCA CHAPTER PRESENTS:

WHAT CORPORATE COUNSEL NEED TO KNOW ABOUT THE REFOCUSSED SEC
THURSDAY, APRIL 7 2011 SESSION 2: CORPORATE

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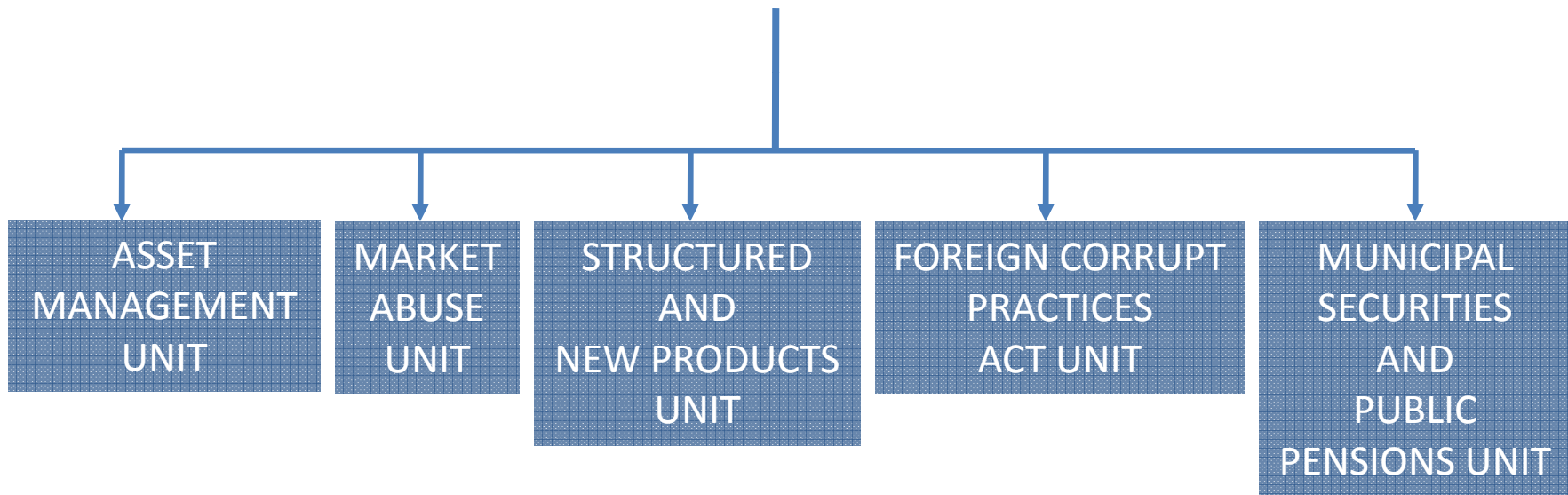


KEY SEC ENFORCEMENT DEVELOPMENTS

- Reorganization and Creation of Specialized Units
- Cooperation Initiatives
- Enhanced Enforcement Authority under Dodd-Frank Act

SPECIALIZED UNITS WITHIN THE DIVISION

ENFORCEMENT DIVISION



SPECIALIZED UNITS WITHIN DIVISION: ASSET MANAGEMENT UNIT

- Focuses on investigating and bringing enforcement cases against investment advisers, investment companies, hedge funds and private equity funds.
 - Largest of the Specialized Units
- The Unit will be “canvassing” hedge funds for ones that outperform “market indexes by 3% and [are] doing it on a steady basis.”
 - **TIP:** important to maintain quality polices and procedures especially those relating to documentation of investment decisions, valuation of assets and trading of securities

SPECIALIZED UNITS WITHIN DIVISION: MARKET ABUSE UNIT

- Focuses on large scale insider trading networks, large cap market manipulations and other abusive market practices.
- **Objective:** *“to go on offense”*
 - Plans to be proactive by identifying patterns, connections, and relationships among traders and institutions at the outset of investigations.
 - Plans to bring “message” cases to expose and deter market abuse

SPECIALIZED UNITS WITHIN DIVISION: MARKET ABUSE UNIT

- **Trader Based Approach:**
 - Looks for patterns across groups of people by a single trader or connected group of traders.
 - According to Unit Chief, Daniel Hawke, this new approach has increased the SEC's ability to detect relationships among traders, and bring cases against large trading networks.
- **Several High Profile Cases brought by Unit in 2010**
 - Ex: Injunctive Charges brought against six expert network consultants and employees of Primary Global Research LLC

SPECIALIZED UNITS WITHIN DIVISION: STRUCTURES AND NEW PRODUCTS UNIT

- Focuses on complex derivatives and financial products
- Goldman Sachs: largest civil penalty imposed against a Wall Street firm in SEC history
 - SEC alleged that Goldman misstated and omitted key facts regarding a CDO it marketed that hinged on the performance of subprime residential mortgage-backed securities.
 - Goldman agreed to pay \$550 million and reform its business practices to settle the SEC charges.

SPECIALIZED UNITS WITHIN DIVISION: FOREIGN CORRUPT PRACTICES ACT UNIT

- Foreign Corrupt Practices Act: prohibits U.S. companies from bribing foreign officials for government contracts and other business.
- Focuses on ways to be proactive in identifying violations of the Foreign Corrupt Practices Act
 - By targeting perceived high-risk industries and companies operating in perceived high-risk locations.
 - SEC FCPA specialized unit in San Francisco.
- 2010 accomplishments: Division instituted twice as many cases as in any prior year and collected more than \$600 million in penalties.

SPECIALIZED UNITS WITHIN DIVISION: MUNICIPAL SECURITIES AND PUBLIC PENSIONS UNIT

- Focuses on “pay-to-play” and public corruption violations, offering and disclosure fraud, tax or arbitrage-driven fraud, public pension accounting and disclosure violations, and valuation and pricing fraud.
- **Case: State of New Jersey**
 - In August 2010, the Enforcement Division brought a cease-and-desist order against the State of New Jersey, predicated on negligence for the state’s failure to disclose material information related to its underfunding of the state’s two largest pension plans

OFFICE OF MARKET INTELLIGENCE

- Enforcement Division created the office of Market Intelligence to gather all tips and complaints in one place.
- **Goals:**
 - triage and develop tips
 - Identify market practices and activities that pose risks to investors
- Currently handling intake and referral of complaints to the proper enforcement staff until Whistleblower office is established.

Office of Compliance Inspections and Examinations

- Works closely with specialized units
- New national governance model
 - Includes regional leadership in key strategic planning, policy setting and performance management initiatives
- New Risk Analysis and Surveillance Unit
 - to enhance ability to identify the highest risk firms that should be examined and the highest risk issues to focus on in exams of those firms
- New Specialization Working Groups
 - dedicated to enhancing ability to identify, understand and proactively examine new and complex industry developments.

THE SEC COOPERATION INITIATIVE

- Cooperation tools
 - Cooperation Agreements
 - Deferred Prosecution Agreements
 - Non-Prosecution Agreements
 - Proffer Agreements
 - Immunity Requests

THE SEC COOPERATION INITIATIVE

- “*extraordinary cooperation*”
- Case: First non-prosecution agreement
 - Carter’s Inc.
 - Relatively isolated nature of unlawful conduct;
 - Prompt and complete self-reporting of the misconduct to the SEC;
 - exemplary and extensive cooperation in the investigation; and
 - Extensive and substantial remedial actions.

CHANGES TO SEC ENFORCEMENT AUTHORITY

- Expanded Authority in Administrative Actions
 - SEC Administrative Authority prior to the Dodd-Frank Act
- Section 929P of the Dodd-Frank Act
 - Advantages to the SEC
 - Settlement Scrutiny
- Case: Rajat Gupta

CHANGES TO SEC ENFORCEMENT AUTHORITY

- Aiders and Abettors
 - Under Private Securities Litigation Reform Act, SEC could bring aiding and abetting actions against any person “who knowingly provides substantial assistance to another” in any violation of the Exchange Act or rules thereunder.”
 - **Dodd-Frank**
 - **Standard:** Knowing v. Recklessness
 - SEC can now pursue actions for aiding and abetting under Securities Act, Investment Advisers Act and Investment Company Act

CHANGES TO SEC ENFORCEMENT AUTHORITY

- Control Person Liability
 - Section 929P(c) of the Dodd Frank Act clarifies that the SEC may bring actions in federal court based on the theory of control person liability provided for in Section 20(a) of the Exchange Act.
 - Who is a control person?
 - Circumstances under which liability arises
 - Defense:
 - Once control person status is proven, the burden is on the defendant to show that he/she acted in good faith.

CHANGES TO SEC ENFORCEMENT AUTHORITY

- Collateral bars or suspensions against securities law violators
 - Section 925 of the Dodd-Frank Act empowers the SEC to bar persons associated with regulated entities not only from their specific securities business, but from the entire securities industry.
- Nationwide Service of Process
 - Under Section 929E of the Act, the SEC's subpoena power in judicial actions is expanded to any location within the US.
- SEC Confidentiality Obligations
 - Section 929I FOIA exemption/ recent Legislation

COOPERATION BETWEEN SEC AND DOJ

- United States v. Stringer
 - No duty to disclose
- Current Law
 - Khuzami Speech v. Enforcement Manuel

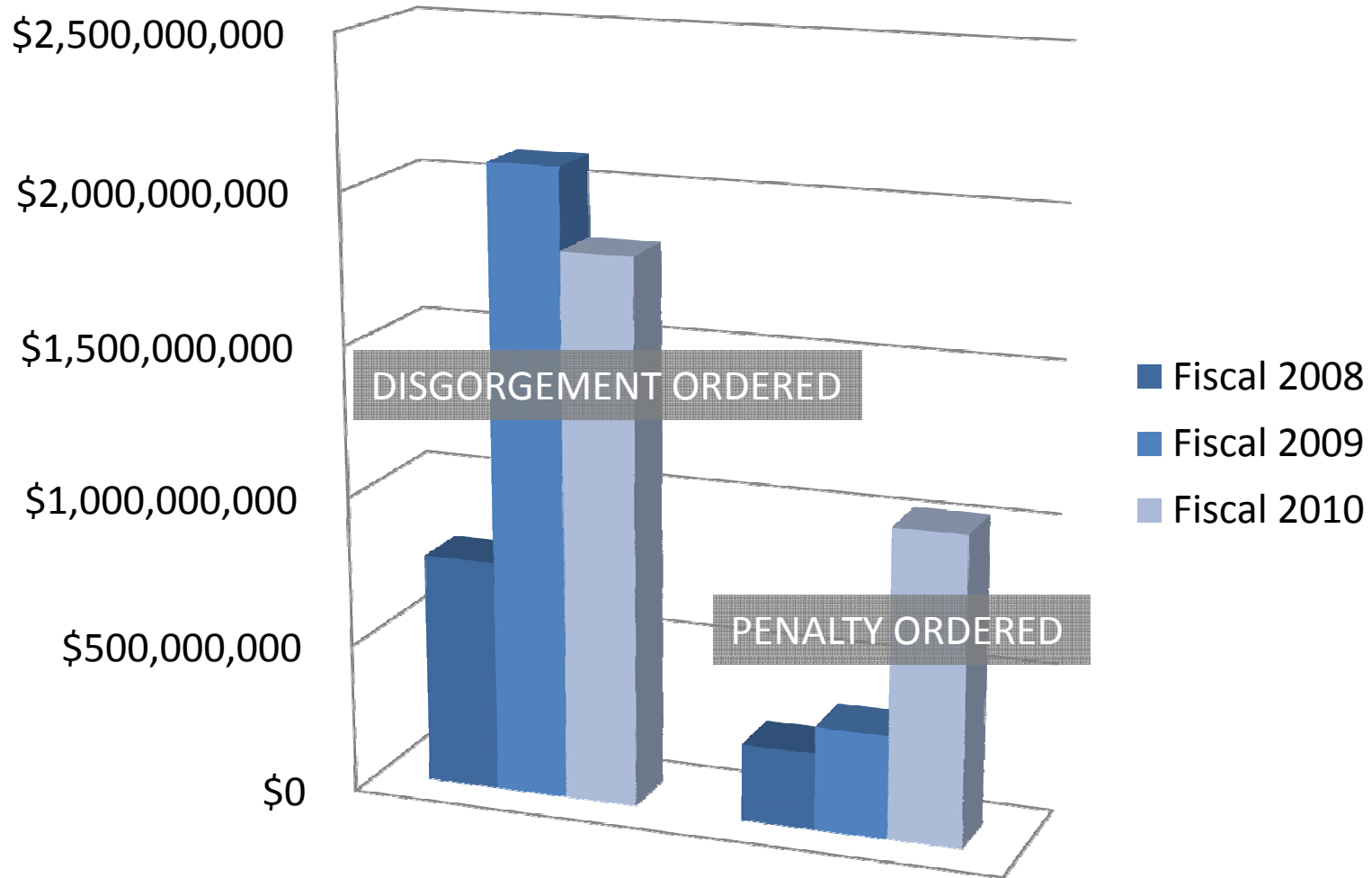
Insurance Coverage for Responding to SEC Subpoenas

- **Director and Officer Insurance:** Defense Costs incurred in SEC and internal investigations
 - MBIA, Inc. v. Federal Ins. Co. (S.D.N.Y.)
 - The district court agreed with MBIA that the broad definition of “Securities Claim” in the MBIA insurance policies encompassed the SEC investigation in its entirety, which includes civil proceedings plus formal and informal regulatory and administrative proceedings and inquiries.
 - Office Depot, Inc. v. National Union Fire Ins. Co. (S.D. FL.)
 - Barred Office Depot from recovering SEC-investigation response costs,, which included internal investigation costs, on the theory that Office Depot voluntarily incurred the costs because the SEC did not invoke administrative or regulatory proceedings against the company. The policy further required the SEC or other regulators to serve subpoenas to trigger coverage.

2010 YEAR IN REVIEW

- Remedies obtained in administrative and federal district court proceedings:
 - Tripled amount of civil monetary penalties from 2009 - \$ 1.03 billion
 - Although disgorgement slightly decreased in 2010, still a significant increase over 2008.

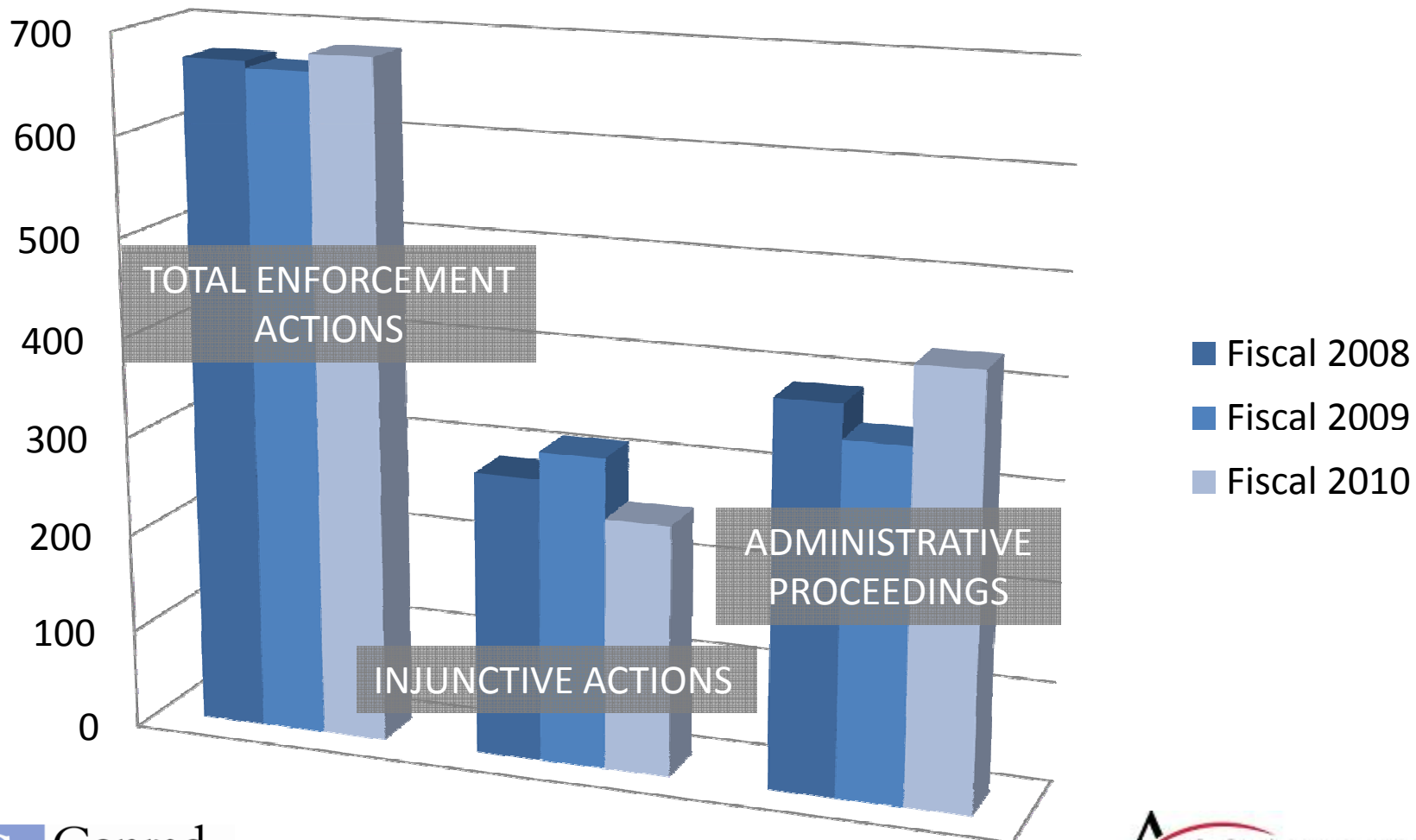
2010 YEAR IN REVIEW *



2010 YEAR IN REVIEW

- Highest Number of Enforcement actions in many years
 - 681 total cases
 - Number of injunctive actions decreased 19% (in Administrative and Federal District Court proceedings).
 - Number of administrative proceedings increased 22%

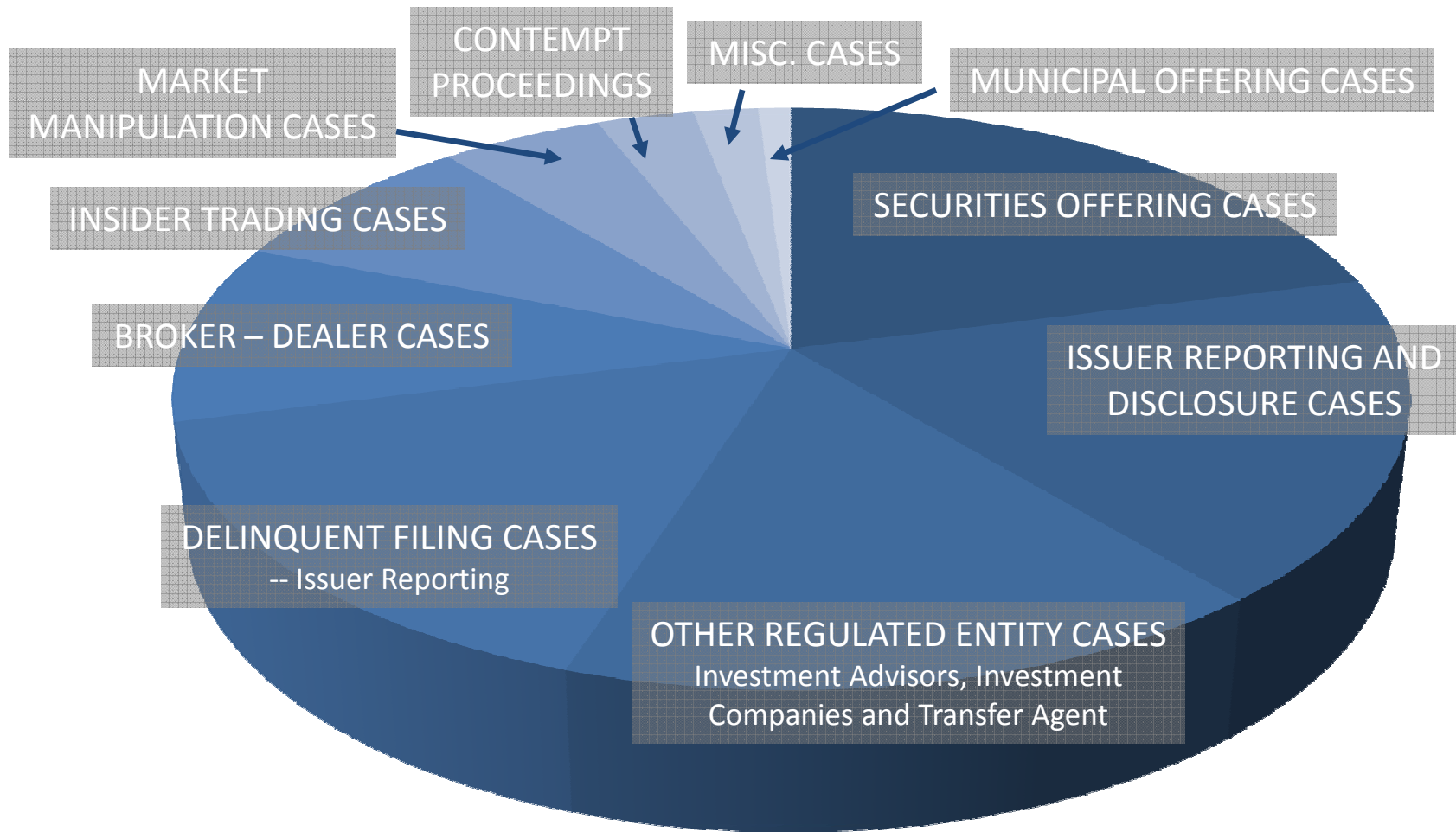
ENFORCEMENT ACTIONS*



2010 YEAR IN REVIEW

- Largest Categories^{*}
 - Securities Offering Cases (21%)
 - Which includes Ponzi Schemes and other offering frauds.
 - Issuer reporting and disclosure cases (18%)
 - Broker-Dealer Cases (10%)
 - Insider Trading Cases (8%)
 - Market Manipulation (5%)

% OF TOTAL ACTIONS



BUDGET

- Budget Constraints
 - FY 2011 Budget not yet passed
 - Operating at fiscal 2010 levels
 - Effect on implementation of actions required under the Dodd-Frank Act
 - Several activities deferred because of budget uncertainty
 - Ex: Delay of Opening Whistleblower Office

CURRENT SEC PRIORITIES

- Current SEC Priorities
 - Credit Crisis
 - Case: Countrywide
 - Largest-Ever Financial Penalty Against a Public Company's Senior Executive
 - Ponzi Schemes; Use of Receivers
 - Case: Merendon Mining, Inc.
 - Alleged \$300 million Ponzi Scheme
 - Still in litigation
 - Insider Trading

CONCLUSION

- What to expect from the SEC going forward
 - Increase in number of enforcement cases
 - Increase in cases brought administratively
 - Increase in cases against individuals
- The SEC's Division of Enforcement has become more aggressive and proactive in enforcing federal securities laws.
 - Companies should review their internal compliance programs to ensure that they are adequately policing for misconduct.

Questions?