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White Collar and Regulatory Enforcement:
Emerging Trends and What to Expect in 2014

Last year, in our annual survey of the white collar and regulatory enforcement landscape, we noted that the trend toward ever more aggressive prosecutions reflected a "gloomy picture" for large companies facing such investigations. Our assessment remains the same, as the pattern of imposing massive fines and extracting huge financial settlements from companies continued unabated in 2013. For example, on November 17, 2013, DOJ announced that it had reached a $13 billion settlement with JPMorgan to resolve claims arising out of the marketing and sale of residential mortgage-backed securities – the largest settlement with a single entity in American history. Johnson & Johnson agreed to pay more than $2.2 billion to resolve criminal and civil investigations into off-label drug marketing and the payment of kickbacks to doctors and pharmacists. Deutsche Bank agreed to pay $1.9 billion to settle claims by the Federal Housing Finance Agency that it made misleading disclosures about mortgage-backed securities sold to Fannie Mae and Freddie Mac. SAC Capital entered a guilty plea to insider trading charges and was subjected to a $1.8 billion financial penalty – the largest insider trading penalty in history. And in the fourth largest FCPA case ever, French oil company Total S.A. agreed to pay $398 million in penalties and disgorgement for bribing an Iranian official. Not to be outdone, the SEC announced that it had recovered a record $3.4 billion in monetary sanctions in the 2013 fiscal year.

Given the government's enormous leverage – particularly over companies in highly regulated industries that are vulnerable to severe collateral consequences, such as those in financial services, government contracting, pharmaceuticals and defense – it is often virtually impossible, except in rare cases, for companies to succeed by pushing back aggressively or litigating. As a result, achieving the most successful outcomes will remain highly dependent upon the steps companies take *before* problems arise. Measures to reinforce and strengthen a company's capacity to prevent and detect wrongdoing are critical to ensuring that, if a problem surfaces, the company will be able to react swiftly and effectively, and will be able to demonstrate that it did everything reasonably possible to foster compliance.

Below we review in detail some of the most important enforcement developments of 2013 and some of the key issues to focus on in 2014.

SEC Enforcement Developments

The SEC's new leadership set ambitious goals for the agency's enforcement program and began steps toward achieving them in 2013. SEC Chair Mary Jo White has spoken publicly of her desire that the enforcement program be perceived to be "everywhere," pursuing violations large and small in all corners of the securities markets. In widely-reported remarks, Andrew Ceresney, Director of the Division of Enforcement, expressed a desire to bring back the "swagger" to the enforcement program. While there is no disputing the clarity of a zero-tolerance message, the SEC is always challenged by the need to deploy its limited resources to get the greatest bang for its enforcement buck. More importantly, historically, in its periods of

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greatest effectiveness, the SEC was known principally as a "tough but fair" enforcer, a formulation that may carry a slightly different connotation.

Rhetoric aside, the best insight to the current condition of the enforcement program comes from reviewing the decisions made and cases brought. Early in her tenure, Chair White determined to change the SEC's decades-old policy of settling cases on a no admit/no deny basis. Despite widespread skepticism about whether this reversal of policy could be achieved, the SEC has now obtained settlements in a few cases in which defendants or respondents made admissions. We can expect more admissions cases in the year ahead. The SEC, however, still has not provided clarity concerning how it will select the cases in which it will seek admissions. Ironically, the change in the SEC's admissions policy grew in part out of judicial skepticism concerning the terms of certain high-profile settlements, including the one at issue in the appeal in *SEC* v. *Citigroup, Inc.*, which was argued in the Second Circuit in February 2013 and is still pending.

Many observers expect that the admissions policy will result in more defendants litigating against the SEC rather than settling. This prediction has not worried Chair White, who pointedly expressed the view in a recent speech that trials are a positive contribution to the administration of justice. Indeed, the Commission had a mixed record in court in 2013, exemplified by a high-profile victory against Fabrice Tourre, and an equally prominent loss in its case against Mark Cuban.

The SEC's whistleblower program also continued to be a significant feature of the enforcement landscape. The SEC received 3,238 whistleblower reports in the year ended September 30, 2013, which was roughly in line with the 3,001 reports in the prior year. The single largest category of reports was again "Corporate Disclosure and Financials." The whistleblower program is a significant contributor to the current upswing in ongoing investigations of accounting and financial reporting matters, a trend that is likely to continue in the coming year.

As a general matter, the size of the civil penalty payments in SEC settlements has been going up. In December, the Commission announced with some fanfare that enforcement actions in fiscal year 2013 set a record with a total of $3.4 billion in monetary sanctions. Other than a general upward trend, there is a limit to the significance of such figures. The $3.4 billion includes disgorgement (return of ill-gotten gains) and prejudgment interest, as well as penalties – and it is the total of monetary sanctions ordered, not the amount of money collected. In the same announcement, the Commission trumpeted that it had opened 908 investigations in 2013 (a 13 percent increase over the prior year) and obtained 574 formal orders of investigation (a 20 percent increase). Again, it is easy to read too much into such figures. Perhaps the best indicator of the limited value of SEC enforcement statistics is the data regarding FCPA cases. The number of cases brought has steadily declined over the past three fiscal years from 20 cases in 2011 to 15 in 2012 and then only 5 in 2013. This decline does not indicate a de-emphasis of FCPA investigations. Rather, it reflects the volatility of small sample sizes – FCPA enforcement continues to be energetic and aggressive. Indeed, the data is a useful reminder that quality is more important to the effectiveness of the enforcement program than quantity. No informed observer would suggest that the SEC has backed away from FCPA enforcement, despite bringing only 5 cases in 2013.

Expansion of Civil Enforcement Tools

Throughout 2013, in a growing trend, federal prosecutors continued to make creative use of civil enforcement powers. In the last year alone, the government reported billions of dollars in civil settlements, with a significant portion of that amount attributable to enforcement against financial services firms. Notably, the cost of such settlements chiefly was borne by public shareholders who had no role in any alleged wrongdoing.

Recent press reports suggest the government hopes to achieve similar results in 2014. Although other industries, such as health care and defense, are familiar with the power and scope of some of these civil enforcement tools, federal prosecutors have aggressively expanded their use against banks and financial services firms even when such firms have repaid federal monies received under TARP and/or settled claims with investors and counter-parties.

The civil enforcement route offers several tactical advantages to federal prosecutors. The Financial Institutions Reform, Recovery, and Enforcement Act of 1989 provides broad, pre-complaint subpoena power allowing U.S. Attorney's Offices throughout the country to engage in wide-ranging discovery of matters potentially involving financial fraud. The threat of large civil penalties under FIRREA — not to mention the treble-damages available under the False Claims Act in matters involving government expenditures — provides the government with overwhelming settlement leverage. Moreover, because these matters are civil as opposed to criminal, the standard of proof is a mere "preponderance of the evidence" — not "beyond a reasonable doubt" — making such cases easier for the government to win if the case is litigated. And, unless the criminal statute of limitations has run, the government may retain the option of converting a civil enforcement matter into a criminal one if it believes the facts so warrant (a threat that, with respect to financial institutions, confers considerable settlement leverage on the government).

Recently, the government has won several judicial rulings enhancing its ability to employ these statues. For example, courts have endorsed the government's position that FIRREA, which provides a civil remedy for fraud that affects a federally insured financial institution, can be used to seek penalties from a bank that has engaged in conduct that *affected itself*; the government need not establish harm to a third-party federally–insured bank. Likewise, courts have agreed with the government that the Wartime Suspension of Limitations Act, as revised in 2008, tolled the statute of limitations of the False Claims Act because of the existing Afghan and Iraqi Congressional war authorizations. Finally, the government has taken the position that civil penalties under FIRREA can be imposed even if a financial institution has already settled with, and been fully released by, investors harmed by the same conduct. This position effectively permits multiple recoveries for the same harm.

Our experience suggests that civil enforcement actions often pose a greater economic threat to companies than many types of criminal actions (which tend to focus on specific actions by individual executives). With U.S. Attorney's Offices now measuring their success in terms of the headline-grabbing amounts of civil penalties or other recoveries obtained, civil divisions often seem to seek the maximum penalty possible in order to refill government

coffers instead of applying the prosecutorial discretion that typically accompanies criminal charging decisions. The potent combination of expansive and costly pre-complaint discovery (without corresponding discovery for defendants), the extension of statutes of limitation due to wartime or other forms of suspension, and huge potential damages upon trial are having a significant *in terrorem* effect, resulting in unprecedented settlements measured in the hundreds of millions, or even billions, of dollars before a complaint is even filed and potentially also discouraging financial services firms from continuing to participate in otherwise beneficial government lending programs because of the unacceptable enforcement risks to public shareholders.

Other government regulators also continue to be active in the civil enforcement areas. In addition to the SEC, which has long made aggressive use of its civil enforcement power, other agencies such as the CFTC, the newly-formed CFPB and bank regulators, such as the OCC and the Federal Reserve, have become much more aggressive in seeking civil enforcement remedies and penalties. State attorneys general have made use of state laws to do the same.

The cautionary message is clear. Any business that receives federal taxpayer money, directly or indirectly, needs to consider the government's dramatically increased appetite for civil enforcement revenue. From compliance programs designed to document adherence to federal program requirements, to periodic audits for exceptions to such compliance, to sound advice from experienced counsel as to how to handle both routine and enforcement-related inquiries, the record of good-faith efforts to satisfy government program requirements can spell the difference between moderate and massive judgments if something goes wrong. In addition, when it appears the government is pursuing a civil matter, companies need to treat it with the same urgency and care they would afford a major criminal investigation. Early efforts to determine the facts, correct any deficiencies, and make a judgment about how to respond to the government's case will be critical.

The Continuing Impact of Morrison

In an interesting and important development concerning the scope of U.S. criminal laws, the Second Circuit held that the presumption against extraterritoriality applies in criminal prosecutions. *United States* v. *Vilar*, 729 F.3d 62 (2d Cir., 2013). The defendants in *Vilar* were prominent investment managers and advisers who had been criminally convicted of securities fraud under Section 10(b) and Rule 10b-5. They argued on appeal that their clients' securities transactions were foreign, and that, as a result, *Morrison* v. *National Australia Bank* required reversal. The Second Circuit found that *Morrison*'s holding applies fully to criminal actions brought under Section 10(b), although it also found sufficient evidence of domestic transactions to sustain the convictions.

Vilar's application of the extraterritoriality canon in a criminal securities-fraud prosecution carries particular significance in light of the prospect that the Dodd-Frank Act appears not to have effectively overturned *Morrison* in securities cases. But as it also confirms that the extraterritoriality canon applies to most criminal laws, *Vilar* undoubtedly portends more frequent invocation of that canon in future transnationally-focused criminal cases and its impact should become clearer over the next year.

Fraud-On-The-Market

In November, the Supreme Court agreed to hear a case that could, depending upon its outcome, dramatically change private securities litigation. *Halliburton Co.* v. *Erica P. John Fund, Inc.*, No. 13-317, presents the question whether the Court should reconsider the fraud-on-the-market presumption of reliance that applies in class actions under Section 10(b) of the Securities Exchange Act and SEC Rule 10b-5. The case is of enormous potential significance. Adopted in 1988 in *Basic* v. *Levinson*, the fraud-on-the-market presumption effectively eliminated the need for plaintiffs to individually prove reliance on alleged misstatements in cases involving securities that trade on "efficient" markets. By dispensing with proof of individualized reliance, *Basic* makes possible the certification of massive Section 10(b) class actions. Without the presumption, classes could not be certified under Federal Rule of Civil Procedure 23(b)(3), because individual reliance questions would predominate over common questions affecting the class as a whole.

While we cannot predict what the Supreme Court will do, there can be little doubt that, at least as far as American public companies are concerned, *Halliburton* could turn out to be one of the most important cases that the Supreme Court has ever decided to hear.

Judicial Scrutiny of DPAs and Plea Agreements

Over the last several years, judicial decisions critical of consent decrees between the SEC and corporate respondents, and the limited role the courts were being asked to play, attracted extensive commentary and press attention. *See, e.g., U.S. Securities and Exchange Commission* v. *Citigroup Global Markets, Inc.*, 827 F.Supp. 2d 328 (S.D.N.Y. 2011). In 2013, several courts applied that same critical approach in the criminal context in their consideration of deferred prosecution agreements ("DPAs") and corporate plea agreements negotiated between the Department of Justice and corporations seeking to resolve criminal investigations.

Most notable was a ruling on July 1, 2013, by the U.S. District Court for the Eastern District of New York, which outlined in detail the legal grounds for judicial review of DPAs and approved a proposed DPA resolving a long-running investigation of HSBC. *U.S.* v. *HSBC Bank USA, N.A. et al.*, 12 CR 763-JG (E.D.N.Y. July 1, 2013). Judge Gleeson's opinion in *HSBC* was the first carefully considered judicial ruling establishing the basis for a court's authority to review and approve a proposed DPA. Significantly, the Court found that its "supervisory authority" was triggered by the joint request by DOJ and HSBC to approve the DPA, but the opinion also noted that in exercising this supervisory authority a court must show appropriate deference to the broad discretion of the Executive Branch, both as to whether to institute a criminal prosecution and as to how aggressively to prosecute any case in light of all relevant circumstances.

Consistent with such deference, the Court in *HSBC* determined to approve the DPA that DOJ and HSBC had negotiated, noting in particular that the DPA would "accomplish a great deal" by requiring HSBC to adopt and maintain a wide array of compliance enhancements and personnel changes to address the identified deficiencies in its anti-money laundering program, and to appoint a corporate compliance monitor to supervise HSBC's remedial measures. Judge Gleeson also ordered the parties to file quarterly reports with the Court

concerning the progress of the DPA's implementation. Upon satisfactory completion by HSBC of the undertakings set forth in the DPA, it is expected the government would dismiss the pending charges at the end of the five-year term of the DPA.

A federal district judge in Massachusetts recently took a more expansive view of the appropriate scope of a court's review of agreements between the government and a corporation in rejecting two plea agreements, each of which were reached pursuant to Rule 11(c)(1)(C) of the Federal Rules of Criminal Procedure. *See* *U.S.* v. *Orthofix, Inc.* No. 12-10169-WGY, and *U.S.* v. *Aptx Vehicle Systems Ltd,* No. 12-10374-WGY (D. Mass. July 26, 2013). Under Rule 11(c)(1)(C), once a court accepts a guilty plea entered into pursuant to an agreement under that rule, it is compelled to impose the sentence contained in that agreement. Citing Judge Rakoff's opinion in the *Citigroup* case, Judge Young concluded that accepting a "(C) plea" in the corporate criminal context was problematic. "[W]hen a court is asked to place its imprimatur on the parties' invocation of the coercive power of the state, it must consider whether the recommended sentence will best serve the public interest. It would be wrong to infer from the parties' confidence that their narrow interests are served by the bargain that the bargain thereby addresses the broad range of concerns which are held by the public."

Unlike Judge Gleeson, Judge Young did not express deference to the Executive Branch in evaluating the agreements. Instead, Judge Young scrutinized the terms of the sentences contained in the agreements, found aspects that he did not believe were in the public interest, and therefore rejected the pleas. In each case, the parties revised their agreements to accommodate the court's concerns in order to obtain the requisite judicial approval.

Significantly, the much-publicized guilty plea of SAC Capital was pursuant to a "(C) plea." The judge assigned to that case, Judge Swain in the Southern District of New York, has indicated that she needs time to review the agreement and has reserved decision on whether to accept the plea until March 2014. It will be important to see how Judge Swain, and other courts, scrutinize DPAs and other agreements subject to court approval in the future, and specifically, how much deference courts continue to afford agreements between corporate defendants and the government. What is certain, however, is that any company negotiating an agreement with the government that is subject to court approval should consider the court's likely reaction and endeavor to ensure that it will withstand scrutiny.

Insider Trading

In 2013, the government marked another year of success in its current campaign against insider trading on Wall Street, with 77 convictions to date through guilty pleas and jury verdicts, and no trial losses. The government's biggest successes of the year involved SAC Capital, the firm owned and run by Steven A. Cohen. The government alleged that the firm was a criminal enterprise with a culture focused primarily on obtaining an "edge" in investment opportunities over its competitors. The government also sought a forfeiture of funds beyond the firm's profits, as well as penalties based on conduct beyond those particular trades alleged to be wrongful. The government justified its stance in part by alleging the firm's compliance systems were akin to mere window-dressing rather than a sincere effort to detect and prevent insider trading by the firm's investment professionals. Based on these allegations, the government was able to extract an unprecedented $1.8 billion settlement from SAC Capital (including related

settlements by the SEC), as well as an agreement by the firm to terminate its investment advisory business. The government also brought an administrative case against Mr. Cohen for failure to reasonably supervise his employees, which is novel in this insider trading context.

While it is unclear whether the government's aggressiveness against SAC and Mr. Cohen will ever be repeated, the case holds important lessons for investment firms and their supervisors. Firms should review their compliance programs to ensure that they can be demonstrated to be sincere and effective, in short *not* "window-dressing." Prosecutors will exercise their discretion based on their perception of whether the institution genuinely was committed to stopping insider trading. Firms should think through what evidence will be available to prove good faith, and whether good faith can be proved without waiving privilege. In addition, the failure to supervise case against Mr. Cohen raises the specific issue of whether "supervisors" may be charged in the future, and how they may avoid such charges through improved compliance and documentation.

Equally important is the fact that the government has exercised restraint in not pushing the limits on the definition of insider trading. When the current campaign against insider trading began, there was considerable concern on Wall Street that the government would retroactively move the goal posts, changing the insider trading law (which is primarily a common law creation) to penalize, and indeed criminalize, research practices that were not obviously unlawful and were accepted business practice on Wall Street, including aspects of the so-called mosaic theory. To date, these fears have not been realized.

Amid an otherwise successful year, the government suffered a high profile loss in the SEC's civil trial against Mark Cuban, who sold his stake in Mamma.com after being told that the company planned a PIPE offering. Mr. Cuban argued that he was not told that the information was confidential and made no promise not to act on it. The case, however, may have limited significance going forward, particularly given the unusual circumstances of that case favorable to the defense – including that the billionaire-defendant was well-liked by his home-town jury, and that the government's key witness provided only prerecorded testimony.

Foreign Corrupt Practices Act/Anti-Corruption Enforcement

As we noted last year, the government issued in November 2012 its long-anticipated formal guidance on the FCPA. Responding to criticism from the corporate community that the so-called benefits of compliance and self-reporting appeared illusory given the parade of huge settlements, the guidance made a point of highlighting several cases in which the government declined to take any action against a company notwithstanding an apparent violation. Distilling that guidance to its core message, the government communicated that companies should redouble their compliance efforts and should disclose any problems that arise notwithstanding such efforts. The government promised in its 2012 guidance that it would reward serious compliance efforts and transparency with real benefits.

In 2013, the SEC then Co-Director (now Director) of Enforcement Andrew Ceresney reiterated that message: "if we find the violations on our own, the consequences will surely be worse than if you had self-reported the conduct." The plain message from the SEC is

that the failure to self-report will result in a bigger "stick" being used. What remains less clear, however, is when companies that do self-report will get a pass – the ultimate "carrot."

That concern has not been eliminated by the much-discussed non-prosecution agreement between the government and Ralph Lauren Corporation in April 2013. The government has held out that NPA as an example of the real benefit to companies that promptly and voluntarily disclose FCPA violations. Ralph Lauren paid what is in today's world a relatively small $1.5 million in penalties and disgorgement to resolve the matter. But the fact that an NPA was required at all raises questions about when a "pass" will be available. That case involved limited misconduct in a single foreign subsidiary that the company self-reported. The government apparently did not view the corporate compliance program as sufficiently robust in the local jurisdiction where the problem occurred; the company had detected the wrongdoing while in the process of making improvements. Companies may be justifiably concerned whether the government will view their compliance programs as sufficiently robust given that it is rare that problems occur without some grounds for criticism of the compliance program at least at the local level.

This continued need for reassurance that self-reporting will bring a tangible benefit is particularly important because the declinations cited in the 2012 guidance may be perceived as having limited "precedential" value. For example, the Morgan Stanley declination, often cited as the paradigmatic case of "credit" given, involved facts demonstrating that the employee alleged to have committed FCPA violations sought to benefit personally at the firm's expense from the scheme and went to great efforts to avoid what was described as the firm's robust FCPA compliance program.

Another key development in 2013 was the sharp increase in enforcement actions against individuals for FCPA violations. Mr. Ceresney recently asserted that the government would be "more creative and aggressive" in pursuing charges against individual defendants. It appears that the model may be the Antitrust Division's cartel enforcement program in which responsible individuals from each corporate defendant are routinely pursued following corporate resolutions.

In addition, the government appears to be focused on the issue of hiring well-connected individuals in China, or elsewhere, and whether such practices may violate the FCPA's prohibition against giving "anything of value" to a foreign official to win "an improper advantage" in retaining business with "corrupt" intent. While there have been prior cases involving intangible benefits, this lesser developed area can present complex questions about just what conduct would constitute a violation. As a result, companies may benefit from enhanced guidance and compliance efforts focused on intangible benefits, including focusing on practices and customs in local jurisdictions.

The government's most recent push underscores more generally the importance of encouraging an appropriate "tone on the ground" (that is, through management, legal and compliance personnel in the local jurisdiction), which is equally essential for FCPA compliance as setting the right "tone from the top." Companies should consider whether their compliance programs may benefit from improving visibility into local practices, and whether local policies, control procedures and training should be implemented to supplement corporate-level

compliance policies and training materials. In particular, companies should consider whether they are adequately addressing issues concerning the potential misuse of intermediaries in foreign countries, a reoccurring theme in major FCPA settlements, including Total, Weatherford, Archer-Daniels Midland, and others in 2013, and now Alcoa this month.

LIBOR and Foreign Exchange Investigations

Global regulators, including U.S. regulatory authorities, had a similarly successful year in their LIBOR manipulation investigations, which have netted $5.8 billion in settlements from financial institutions since 2012. Regulatory authorities continue to announce new cases against financial institutions, while also pursuing charges against individual traders and brokers. One notable aspect of these investigations has been the increased cross-border cooperation and coordination between U.S. and foreign regulators in their extensive probes of the alleged manipulation. Though such cooperation was sparked by the LIBOR scandal, it has extended beyond the confines of that investigation into similar efforts related to other benchmark rates, like foreign exchange (or "forex") rates, that are prone to manipulation. In fact, Attorney General Eric Holder has asserted that "[t]he manipulation we've seen so far may just be the tip of the iceberg."

As the government learns more about different markets, how traders operate in those markets, and how firms communicate with each other, it will become more sophisticated in spotting potential issues relating to market-rigging, antitrust, fraud and other violations. Firms should anticipate such problems by examining their own business activities with greater specificity and evaluating the adequacy of existing compliance programs. Additional training of personnel and implementation of effective controls before an issue arises may be appropriate. Further, as was the case in the LIBOR scandal, firms that engage in corrective action early may be rewarded for their proactive approach.

Other Cross-Border Law Enforcement Developments

As noted above, a developing trend in recent years has been the prevalence of cross-border investigations and enforcement actions by U.S. authorities, facilitated by increasing levels of cooperation between U.S. regulators and their counterparts in foreign jurisdictions. Perhaps the most noteworthy example in 2013 was the U.S. Department of Justice's Program for Swiss Banks. Announced on August 29, 2013, in conjunction with a Joint Statement between U.S. and Swiss authorities, the Program offered an innovative solution for Swiss Banks seeking to resolve their status in relation to the Department's ongoing investigations of offshore tax evasion. Among the first of its kind, the Program offered a standardized settlement template supported by the Swiss government: eligible Swiss Banks that may have committed tax offenses in servicing U.S. clients could seek Non-Prosecution Agreements (subject to the payment of penalties calculated pursuant to certain guidelines), while Swiss Banks that could demonstrate that they did not engage in any facilitation of tax evasion by U.S. persons could seek Non-Target Letters (subject to verification by an independent examiner). While it remains to be seen how

many of the approximately 300 eligible Swiss Banks will participate, the Program, if successful, could represent a model for future industry-wide resolutions of U.S. authorities' cross-border investigations.

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