SECURITIES

THE SECURITIES AND EXCHANGE COMMISSION IS IN THE MIDST OF A TOP BRASS UPHEAVAL. OUR panel of experts discusses the significance of those changes as well as judicial scrutiny of settlements, and class certification. They are Jordan Eth and Craig D. Martin of Morrison & Foerster; Richard Heimann of Lieff Cabraser Heimann & Bernstein; Matthew L. Larrabee of Dechert; and Thomas Stevens of U.S. Department of Justice. The roundtable was moderated by *California Lawyer* and reported by Cherree Peterson of Barkley Court Reporters.

EXECUTIVE SUMMARY

MODERATOR: What changes do you anticipate under the new Securities and Exchange Commission leadership? How might it impact settlements and increasing judicial scrutiny of settlements?

LARRABEE: What we would like to see over the next several years, which we have not seen recently, is more stability and consistency at the SEC. There's been a tremendous amount of change, and more recently there's been a tremendous amount of turnover. With Mary Jo White as the new chair of the commission, new general counsel Geoff Aronow, the departure of Rob Kaplan to private practice and the replacement of Robert Khuzami by George Canellos, it's a fundamentally different lineup of people at the top. With some stability we'd hope to get a little more consistency and predictability. That would help all of us—investors, businesses, executives, and the SEC.

MARTIN: Mary Jo White is, of course, a former prosecutor and some have speculated about whether that experience will cause her to bring a different focus to the chair. But given that Rob Khuzami—also a former prosecutor—worked very hard to incorporate a prosecutorial model into the SEC's enforcement program over the last three years, her ability to do much more in that regard is limited. And as much as she may want to focus on enforcement, other aspects of that job will demand her attention, such as implementation of Dodd-Frank and writing JOBS Act rules .

STEVENS: First, all of the comments that I make today are my own, and do not necessarily express the view of the United States Attorney's office, the Department of Justice, or the SEC. There have been a lot of changes at the SEC, and from the perspective of someone who works with the SEC almost every day, those changes have been beneficial. The SEC is now faster, more aggressive, and innovative. Rob Khuzami, George Canellos, and Mary Jo White all have been federal prosecutors. Their understanding of the criminal side is extremely helpful with respect to our parallel investigations.

HEIMANN: From the plaintiffs' perspective, we're on the sidelines pretty much, but we're cheering on the SEC. We're very much in favor of an aggressive SEC and working in tandem with the DOJ and hopeful that the SEC will continue their aggressive actions going forward.

ETH: Anytime I hear a prosecutor say that he's encouraged by the SEC, and a plaintiffs lawyer cheering them on, I start to worry. We have seen Khuzami and company put a lot of tools in place. It also took a lot of effort to dislodge practices that had accumulated over decades at the SEC. I don't know that they really got a chance to try out all of these new toys. The whistleblower provisions, for example, were a big deal in Dodd-Frank, and there's been precisely one case based on a whistleblower award so far. That doesn't mean there won't be dozens or hundreds in the future. We're starting to see wiretapping, something that was unheard of in these cases. Now we have former Assistant U. S. Attorneys, not just at the top but throughout the organization. So are we about to see the SEC really take off in a much more aggressive manner using all of these new tools that they have?

LARRABEE: That's the question that worries most defense lawyers. The SEC still faces a lot of political pressure to be even tougher than they have been in the past two years. For example, Columbia professor John Coffee recently published a *National Law Journal* article characterizing Khuzami and Canellos as essentially party to a regime that gave out parking tickets for securities fraud during the financial crisis. I thought this was quite unfair, but it had to sting,

as it prompted them to take the unusual step of publishing a rebuttal. I would hope that we would get to a point soon where the SEC can state with confidence that they are "tough enough" to accomplish their objectives in protecting investors. It's not the SEC's job to prove they are the toughest folks around and it's not their job to vent society's frustrations about what happened during the financial crisis, as awful as it was for all of us living through the turmoil. Whether they can find that balance with all the new tools and toys that Jordan [Eth] referenced is a really good question and as important as anything else to keep an eye on in the next few years.

MARTIN: One of the tools announced to great fanfare in 2010 was the non-prosecution agreement and deferred prosecution agreement that had been and remains a mainstay of the Justice program. Look how little the SEC has done with that tool—they've entered into five agreements total since 2010, whereas the DOJ had 35 last year alone. It raises the question of whether this simply takes time to implement, or whether that tool just doesn't lend itself to the SEC's culture and the structure of its civil enforcement program.

LARRABEE: The answer to that question might turn on the outcome in the Second Circuit of the appeal from Judge Rakoff's refusal to embrace the SEC settlement in the Citibank case (*SEC vs. Citigroup Global Mkts., Inc.*,827 F.Supp.2d 328 (S.D.N.Y. 2011)). To the extent federal judges' discretion to simply reject these settlements is affirmed by the Second Circuit, the SEC and the defendants may well be looking for alternatives to those kind of settlements, and as you note deferred prosecution agreements and non-prosecution agreements may be part of the answer. It is worth noting that other judges are watching this. I have several class actions in front of Judge Kane in the District of Colorado, who recently issued an opinion in a SEC case.

MARTIN: *Bridge Premium Finance*. (*SEC v. Bridge Premium Finance*, No.12-CV-2131 (D. Col. filed January 17, 2013).)

LARRABEE: Right. Judge Kane's ruling essentially said, "In my courtroom if you're getting prosecuted by the SEC, you have two choices: Admit guilt or go to trial. Take whichever one suits you best." That kind of approach will inhibit a lot of settlements and will likely create incentives for people to look at alternatives.

MARTIN: Judge Leon in D.C. has held up a couple of FCPA settlements—*Tyco* and *IBM*. (*SEC v. Tyco International Ltd*, No. 12-CV-1583 (D.D.C.) and *SEC v. International Business Machines Corp.*, No. 11-CV-563 (D.D.C.).) In the latter, he said that the settlement should require ongoing reporting by IBM to the court concerning compliance. And Judge Kane's comments in *Bridge Premium Finance* were interesting given that they are so at odds with the reasoning of the Second Circuit's opinion staying the trial Judge Rakoff ordered in the *Citigroup* case.

STEVENS: Regardless of how the *Citigroup* and FCPA settlements turn out—everybody is looking at this issue now. When I contemplate what sort of settlement, if any, there should be with corporate defendants, it's impossible to ignore these developments. I'll take a much harder look at the threshold question of whether there can be a settlement on fair and appropriate terms, consistent with DOJ policy; and if a settlement is appropriate, I'll have these recent developments in mind when asking myself, what should it look like and what are the specific terms and conditions?

HEIMANN: While on the sidelines, I do have an interest in how it comes out because of the implications that admissions of culpability have in parallel civil proceedings. But I pose the question here, why shouldn't the federal judge have the authority to insist on admissions of liability, particularly where evidence is strong and the misconduct is serious?

ETH: In private cases in every single settlement there's a denial of a wrongdoing. And there's good reason for that. Because if you actually have to have an admission of liability in all these cases—and this is one of the arguments in front of the Second Circuit—the government will be overwhelmed and can't then decide which ones to litigate.

HEIMANN: I don't know that that would happen though. Look at the criminal process. Ninety-plus percent of criminal cases are resolved by plea bargains and those end up with admissions of guilt in almost all cases. Why is it so different on the civil side where we're talking about the government pursuing what are serious financial offenses? I don't know that it would necessarily result in a multiple increase in the number of cases that actually go to trial.

ETH: In the criminal context in plea bargains, if you have "beyond a reasonable doubt" evidence that someone has committed a crime and the issue is whether they do 30 years or five and what will they plead to, that's one thing. But we're talking about awfully subtle cases in many circumstances where they're not close to criminal. They're brought under a civil standard where the situation might be that after sifting through the millions of emails you've decided that someone more likely than not knew that these exotic securities were not worth what they said they were and so on.

HEIMANN: I posed the question by making two qualifications—if the evidence is strong and the conduct is serious. A standard model of the SEC consistently not requiring admissions of responsibility when they settle is wrong. They ought to put more attention into the serious cases where the evidence is strong and insisting on admissions of culpability.

LARRABEE: That's the root question: What is the limit of the SEC's discretion? By definition we're talking about a situation in which the prosecuting agency has decided they prefer to compromise. So why would you override the SEC's judgment? I saw comments attributed to Judge Rakoff's counsel in the Second Circuit argument to the effect of, " the good judge only wanted more information." If that really is the case that's easily remedied—to get settlements approved in civil class actions the parties provide a mountain of evidence about the claims, defenses and risks. But if the issue is fundamentally one of judicial disagreement on whether we should have more admissions or more trials, which is closer to the comments from Judge Kane, that really is a question of whose discretion controls? Who's making the ultimate judgment here—and why?

STEVENS: This is a sensitive subject area so let me reiterate that I'm speaking for myself and not the DOJ or any other agency. Two thoughts come to mind. One is if there was serious misconduct and strong evidence, as Richard [Heimann] posited—and it's unclear what that means—that may be a situation that affects the nature of the settlement. But if someone is required to admit that they have committed a securities fraud, the implications for criminal exposure could be quite serious. An "admission of liability" requirement would give potential settling parties great pause, I would think. To Jordan [Eth's] point about resources, it may be an agency judgment that if it can settle a hundred cases with X amount of resources, it's going to get more beneficial regulatory effect from that enforcement strategy than requiring an admission of liability while shrinking that settlement pool to only a few cases. It may be an overall balancing to achieve the greater good, and it seems to me that that type of judgment is entitled to great deference.

HEIMANN: What set off Judge Rakoff, I think, was that the SEC routinely does not insist upon admissions, and in fact, I don't know of any case in my experience where they actually obtained formal admissions of responsibility. He saw that as a practice and just a foregone conclusion, which he doesn't like.

MARTIN: The SEC has responded to that kind of criticism with a greater focus on individual defendants. The number of settlements with the SEC in fiscal 2012 was up somewhat, but the real movement was in the number of settlements reached with individuals. Sure, those settlements doubtless required no admission of wrongdoing, but they reflect a sometimes misguided effort to hold people individually responsible for corporate violations.

LARRABEE: To the extent that particular prosecutorial response was intended to send a message, that message is getting out to the financial community. Certainly most defense lawyers advise their clients today about the increased risk of individual liability. And if you look at the outcomes for the individuals recently, yes, most

of them do not require an admission of liability. But if you're an individual defendant who achieves one of the current settlements, it likely means you are suspended from an industry for a year, paid hundreds of thousands or millions of dollars in personal, uninsured restitution after three years of intense litigation where your name has been dragged through the press as a target of the SEC for violating the securities laws. You also likely have been through equally painful civil litigation. The simple truth is there are very few people who watch this with any care and say, "I'd like to repeat that." This individual prosecution focus has achieved increased deterrence.

MODERATOR: How has the SEC and DOJ's increased coordination affected the securities practice area?

STEVENS: Our office really values our relationship with the SEC, particularly here in San Francisco. They have terrific leadership, very smart lawyers and staff accountants and are quite frequently on the front edge of a lot of the fraud. They are proactive and will call us on Day One if they think their evidence warrants a parallel investigation. Recently we've seen that model expand to other civil agencies. For instance, there's been some parallel proceedings involving DOJ and the FDIC. In the Dodd-Frank Act, there is a provision that has opened communication even more. Section 24(f) of the '34 Act is a non-waiver provision by which the SEC can share information with us and vice versa. There was reticence before about sharing information because somebody down the road might claim it was a waiver. That provision, while it's not brand new, is being used more and relates to our earlier discussion about the pipeline generated by the reforms. It is increasing the level and quality of communication between agencies because confidential information is protected; consequently, parallel investigations can move forward a lot faster and more effectively.

MARTIN: That close coordination between the SEC and the U.S. Attorney's office is a fact of life now for defense attorneys, but until recent times, it was somewhat controversial. There was a line of cases holding that if the SEC was cooperating with the DOJ in an investigation, the SEC had an affirmative duty to inform a witness, and failure to do so violated the witness's Fifth Amendment right against self-incrimination. A few years ago the Ninth Circuit took care of that in *U.S. v. Stringer*, so anytime we're representing an individual in an SEC investigation, we assume that the Department of Justice is there or could be there on very short notice. (*United States v. Stringer*, 535 F.3d 929 (9th Cir. 2008).)

ETH: It used to be the SEC's affirmative obligation to disclose a referral to DOJ. Now it's on defense counsel. And even if defense counsel hears there's nothing going on right now, that doesn't mean in a week or a month the answer will be the same. It puts tremendous pressure on defendants because what maybe was the model from years ago where during an investigation one firm represents five officers and two directors and the company, now it might be that you've got to start jettisoning people and make tactical choices. Costs go through the roof, and the complexity increases quite rapidly because people's freedom is at stake.

STEVENS: In criminal cases discovery is a big issue. And there's been a lot of controversy over that in recent years. One of the issues is, who is on the "prosecution team" during a parallel investigation? There are policies and other standards concerning when another agency lawyer is, or is not, part of the prosecution team. I've personally leaned toward the assumption that they are part of it, out of an abundance of caution. But then we should also get the benefit from that relationship—so we cooperate fully in connection with tasks such as discovery review and interviews. It's another data point towards the notion that parallel investigations are becoming more effective, faster, and of higher quality.

ETH: Tom [Stevens], what about stays of civil litigation while the criminal litigation is going on? Let's say there's an SEC complaint and you're also working up the criminal case. Sometimes defense lawyers will use the SEC case as a way to depose all of your trial witnesses. Judges in the past almost automatically would stay the SEC case in deference to the DOJ case.

STEVENS: There's a line of cases that have been decided the way you described. There may be very good reasons to stay a civil case. There may be some highly sensitive issues under investigation that are not public, and those things shouldn't come out. Under those circumstances, I would obviously urge the court to stay it. And there's a key distinction between pre-indictment and post-indictment posture. The former implicates a lot of sensitivity. Post-indictment, we have discovery obligations, and, absent circumstances that are unusual in white-collar cases, I'd rather have everything out in the open. The witnesses are going to have to testify anyway, so, if parallel civil discovery must proceed, and I'm certainly not inviting that prospect, I'd like to know what they said under examination by, hopefully, some very good lawyers. It gives a preliminary view of how the case will play out, its strengths and weaknesses, and then I don't have to go to sleep every night wondering whether something horrible will happen during trial.

MARTIN: There are opportunities for a defendant to get a sneak preview of your case, just as you get a sneak preview of what the defense witnesses would say. But it can put the defendant in an awful bind because that defendant may very well want to invoke his Fifth Amendment rights in anticipation of a criminal trial, but at the same time is facing a negative inference in the SEC matter.

MODERATOR: What is the significance of the current division in authority over whether *American Pipe & Construction Co. v. Utah* tolls the statute of repose and what are the possible outcomes?

HEIMANN: This is a very recent development in the law, but let me preface the discussion of it by saying once upon a time in securities class litigation, class certification was very straightforward. It was virtually a foregone conclusion and as a result often resolved relatively early in the case. But in more recent times, as a result primarily of decisions coming out of the Eleventh and the Fifth Circuit courts, class certification in

securities cases has become much more complex and complicated. And defense counsel in many cases is vehemently resisting class certification entirely or at least in substantial part.

The consequence of that, at least for purposes of this issue, is that often class certification is not decided until after the statute of repose—three years in the case of the '33 Act and five years in the '34 Act—has actually expired. That is significant because over the last decade an increasing number of large institutional investors have become willing to opt out of securities cases rather than accept their share of what inevitably turns out to be a class settlement, particularly once they've seen what they're likely to get out of the settlement. Thinking that they can do better, which they almost always can if they opt out, they do choose to opt out.

Up until 2011 every federal court that had looked at whether or not *American Pipe* tolling applies to statutes of repose as opposed to statutes of limitations, had decided that *American Pipe* tolling covers both. (See *American Pipe & Constr. Co. v. Utah*, 414 U.S. 538 (1974).) But the only circuit decision on point was from the Tenth many years ago holding that tolling does apply. And then along comes Judge Castel in the S.D.N.Y. in *Footbridge Ltd. Trust v. Countrywide Fin. Corp*, 770 F. Supp. 2d 618 (S.D.N.Y. 2011) who held that the *American Pipe* tolling does not apply to statutes of repose. Since that decision one other judge in that district has agreed, while others both in that district and in other districts have concluded that tolling does apply.

Now the issue is before the Second Circuit in a case that we're involved in that was argued in December. If the Second Circuit goes the other way, it will create a very problematic situation for the judicial system and institutional investors who are inclined to consider opting out. If the Second Circuit were to uphold the view that statutes of repose are not tolled by *American Pipe*, then institutional investors who are thinking about opting out may be required to opt out and file their own lawsuits before class certification is decided. And that presents the exact scenario that *American Pipe* was designed to prevent, which is a multiplicity of lawsuits filed before a determination on the issue of class certification.

LARRABEE: What is the best argument for tolling the statute of repose that complies with the statutory language? Because the statutory language seems pretty unequivocal. At least in the '33 Act, the statute of repose provides that "in no event" may an action of that statute be brought more than three years after the security was offered to the public or sold.

HEIMANN: That's the language of one act. Of course, it doesn't appear in the other act. The simplest argument is that the filing of the class action effectively is the filing of the action on behalf of all putative class members. In a strictest sense American Pipe isn't really a tolling rule at all, it simply recognizes that when a class action is filed it is done so on behalf of all those who are within the definition of the class. And therefore the members of the class have already brought their action at that point in time. So the "in no event" language about precluding the filing of a subsequent complaint is irrelevant. And I think that's probably the simplest response to that language.

ETH: If you look at the Supreme Court's cases over the last several years, they do seem interested in statute of limitations in this area. If the Tenth Circuit has said that tolling does apply and the Second Circuit goes the other way, this could wind up in front of the Court. And as currently constituted, I bet the Court goes with the plain language argument. And it sounds like you think that's a problem because it would lead to multiplicity. I could imagine a bunch of people opting out, filing lawsuits, they all get stayed so that the parties and the court can see what happens down the road. And really all you're doing is flushing out the cases at an earlier stage.

HEIMANN: From the standpoint both of class counsel and defense counsel, it presents an interesting conundrum. I would think that defense counsel would not favor having a bunch of large institutions file individual actions against their client. From lead class counsel's point of view, you don't want opt-outs because you want to be in control of the litigation. And the more opt outs there are, the more weakened the class case is, particularly if these are large opt-outs. But the real loser is the judicial system. Judges don't want to be burdened with multiple cases when the class action itself could resolve the entire matter.

LARRABEE: Assuming the law went the way Jordan [Eth] was predicting, it wouldn't be that hard to imagine plaintiffs going to the trial courts and saying you better hurry up with class certification, in light of your hypothetical, which is very often correct, where class certification can take longer than the statute of repose, from event to decision.

HEIMANN: Sure, but given the complexity that has arisen on class issues, oftentimes now plaintiffs need discovery in order to establish the requirements for class certification. And even if that's not the case, defense counsel may want to take discovery to try and develop arguments that will be useful in opposing class certification.

ETH: There might also be pressure on lead plaintiff and lead counsel determinations. As a defendant, I generally prefer to have fewer plaintiffs and fewer counsel. I don't want to have seven law firms aligned against me for all kinds of reasons. But there are situations where you'll have different law firms vying for lead. And if they don't get it, they're waiting in the wings as a potential opt out. Class counsel doesn't want the big opt out to occur, and if the law goes a certain way they'll know that might happen and it might change lead counsel structures.

HEIMANN: The lead counsel phenomenon can be a difficult and complicated matter. Yes, that could be an additional factor into that dynamic, but I doubt very much that it's going to drive the outcomes. While determination of class certification has become prolonged over time, determination of lead counsel can take an inordinate amount of time too. And nothing happens in a case before that's decided. Then there's the round of 12(b)(6) motions. I've been in cases where it takes up to two or three years to get a decision out of a judge on a simple motion to dismiss. And you don't get to class cert until that's decided. So all of that plays into the difficulty posed by this notion of whether or not the statutes of repose get tolled by *American Pipe* or not. ■

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