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## 5 Tips for Surviving a Fight with the SEC

### From the Experts

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If 2013 was a tough year in the courtroom for the U.S. Securities and Exchange Commission, 2014 is not shaping up to be much better.

In October the SEC lost a high-profile insider trading case against billionaire Mark Cuban. In December a Kansas City jury completely exonerated our client, NIC Inc. CFO Stephen Kovzan, on claims that he failed to disclose expenses incurred by the CEO as “perquisite” compensation. Later that month, the SEC lost a revenue recognition accounting fraud case in Los Angeles. January brought three additional insider trading losses in Atlanta and Chicago.

Even the SEC’s few recent trial victories were underwhelming. In an accounting fraud case tried in Austin, Texas, earlier this month, the jury rejected the majority of the SEC’s fraud theory and nine out of its 11 legal claims. A Minneapolis jury reached a verdict that appears irreconcilable, finding under one law that the defendant intentionally facilitated a Ponzi scheme, but under another law that he didn’t. The agency won a complete victory in a mortgage-backed securities fraud case in Florida, but that was against a defendant who was representing himself—hardly a fair fight.



When a government agency’s track record in court looks like this, you might expect its leaders to ask, “Do we need to pick our cases more carefully?”

But SEC enforcement director Andrew Ceresney recently told *The Washington Post*, “If you’re not losing cases, you’re not being aggressive enough.”

Mr. Ceresney’s comment came as no surprise to us. Over our combined 23 years representing clients in SEC matters, willingness to push the envelope in close cases—to “regulate by enforcement”—has been a hallmark of the agency’s enforcement division.

So what can you do to stay out of the SEC’s crosshairs? And how do you weather the storm if the SEC comes after you? Here are five simple things to keep in mind.

### 1. Culture Matters

The easiest way to avoid trouble with the SEC is to steer clear of practices that concern the SEC. Emphasizing throughout your organization the importance of doing things right and dealing fairly with counterparties and investors reduces the likelihood of legal missteps, and can provide compelling evidence that any

mistakes that do occur were isolated or unintentional and not inspired or condoned by management.

When employees believe that the company wants them to do the right thing, they are more likely to report problems internally rather than send whistleblower complaints to the SEC. That trust can also pay off if the SEC decides to take investigative testimony or file an enforcement action. Employees who believe in the integrity of their firm are likely to be valuable witnesses for the company.

### 2. Train People to Use Common Sense in Emails

Emails are the first thing the SEC subpoenas in most investigations, and they're often portrayed as "smoking guns" in SEC enforcement actions. From the SEC's perspective, off-the-cuff email remarks—which may never have been intended to be taken literally—provide a window into the author's "true" beliefs. When the SEC's suspicion is aroused, poor word choice and ambiguity will be interpreted in the worst possible light. Inflammatory speculation and sarcasm will be treated as fact.

Bad emails are the white-collar equivalent of self-inflicted wounds. Do yourself a favor and avoid loose language in email correspondence. Be precise. And for complicated matters, pick up the phone or have an in-person meeting instead.

### 3. Get Good Insurance

The importance of good insurance coverage can't be overstated. Are your policy limits high enough? Does your insurance carrier have a reputation for standing behind its insureds? If possible, upgrade to a policy that covers government investigations. A policy that gives individual officers and directors the right to coverage if the firm can't advance defense costs ("Side-A" coverage) is highly desirable as well.

Remember, SEC investigations and enforcement actions can drag on for years. Mark Cuban's trial focused on a single stock sale, yet his defense cost \$12 million. Complex cases run up even larger bills. You want a policy that can go the distance if that's what it takes.

### 4. Don't Just Roll Over

In the past, firms threatened with SEC enforcement action usually opted to settle rather than jeopardize their existence by litigating. But in today's regulatory "tough cop" environment, SEC settlement terms have become harder to swallow.

The SEC may demand an admission of wrongdoing. That admission could put you at the mercy of the plaintiffs' bar in follow-on civil actions.

Disgorgement of alleged "ill-gotten gains," steep civil money penalties, a permanent injunction and a bar from working in the industry are other common settlement demands. Individuals who settle on those terms can face serious financial, professional and reputational hardship.

Given the high stakes, the charging stage of an SEC investigation is no time to just roll over.

You should instead make the SEC staff explain why they believe the evidence proves a securities law violation. Are the SEC's proposed charges supported by convincing and admissible evidence, as opposed to weak circumstantial evidence and speculation? Is the SEC stretching the boundaries of the law?

Engage with the SEC's trial staff—the lawyers who will have to prove the case in court. They have not invested months or years in the investigative phase. Often, they have a more independent perspective.

Realistically assessing both your litigation risks and the SEC's at the charging stage can pay big dividends. When the SEC overreaches, the odds of

negotiating an acceptable settlement or convincing a court to dismiss the SEC's charges improve dramatically.

### 5. Litigation Levels the Playing Field

At the investigation stage, the best strategy usually is to cooperate and attempt to convince the SEC staff that enforcement action is not warranted. After it files charges in court, however, the SEC becomes just another civil plaintiff. The Federal Rules of Civil Procedure apply, and the playing field levels.

Where the SEC takes liberties with the law or the facts, challenge its assertions. If the court won't dismiss the complaint, be aggressive in discovery. The SEC has to show you its cards. You get to review its investigative file, subpoena additional records and depose witnesses. In some cases, you can demand to see agency documents outside the investigative file and depose relevant SEC employees. We've done this (over the SEC staff's vigorous objections) when the agency's conflicting positions on legal and accounting standards supported our client's defenses.

While the SEC is a formidable adversary, its recent losing streak shows that courts and juries will hold the agency to its burden of proof. Now more than ever, if you believe the SEC's position is unjustified, the best response may be, "See you in court."

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