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REPORT

ENFORCEMENT

Top 10 SEC Enforcement Developments of 2007

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This article highlights significant developments during 2007 in the enforcement program of the U.S. Securities and Exchange Commission ("SEC"). Developments were selected because they may signal future trends or establish new legal standards.

The subprime lending meltdown may have been the most significant event in 2007 for securities enforcement regulators and counsel, and will likely lead the list of important SEC enforcement developments of 2008. However, there were no SEC subprime enforcement proceedings initiated in 2007, and, accordingly, this review of enforcement developments does not include any subprime cases. Instead, the Number One enforcement development of 2007 was the significant increase in both the number of cases brought under the Foreign Corrupt Practices Act of 1977 ("FCPA") and the level of sanctions levied in such cases, including the largest FCPA penalty to date.

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The Number Two enforcement development of 2007 is the volume of enforcement cases alleging improper backdating of stock options, including the first forfeiture of compensation under Sarbanes-Oxley's "clawback" provision.

The remaining Top Ten developments illustrate other significant issues and trends in the SEC enforcement program:

- Number Three is a decision of the U.S. Supreme Court calling into question the SEC's long-standing interpretation of "willfulness."
- Number Four is the SEC's continuing struggle with the imposition of corporate penalties.
- Number Five is the first case against a broker-dealer for its failure to file Suspicious Activity Reports.
- Number Six is the cluster of SEC proceedings initiated against audit firms and partners for failing to register with the Public Company Accounting Oversight Board.
- Number Seven is the prosecution of an outside attorney in connection with the collapse of Refco Group, Ltd. and Refco, Inc. ("Refco").
- Number Eight is the first district court opinion rejecting the SEC's view that covering short positions with stock obtained in Private Investment in Public Equity ("PIPE") transactions violates Section 5 of the Securities Act of 1933 ("Securities Act").

■ Number Nine is the continuing fallout from market timing, and in particular a procedural ruling by the SEC regarding discovery in its administrative proceedings.

■ Number Ten is a Fourth Circuit opinion upholding venue in Alexandria, Virginia, where SEC filings are electronically processed.

1. The Number of FCPA Cases and the Level of Sanctions Increase Sharply. In 2007, the SEC, as well as the Department of Justice ("DOJ"), brought more FCPA actions and obtained sharply higher monetary sanctions.

A. El Paso Corp.

On Feb. 7, 2007, the SEC brought a settled enforcement action against El Paso Corp. alleging violations of the books and records and internal controls provisions of the FCPA.[1] The SEC alleged that El Paso and its predecessor in interest, The Coastal Corporation, made approximately $5.5 million in illegal surcharge payments to Iraq between June 2001 and June 2002 in connection with the Company's participation in the U.N. Oil for Food Program. The illegal surcharges were then passed back to El Paso. The SEC also alleged that El Paso's failure to detect and prevent such payments evidenced a failure to maintain an adequate system of internal controls and that El Paso failed to record the proper nature of the payments. Without admitting or denying the allegations, El Paso consented to a permanent injunction from future violations of Sections 13(b)(2)(A) and 13(b)(2)(B) of the Securities Exchange Act of 1934 ("Exchange Act"), as well as to pay disgorgement in the amount of $5.48 million and a civil penalty of $2.25 million. El Paso also entered into a non-prosecution agreement with the U.S. Attorney's Office for the Southern District of New York.

B. Baker Hughes Inc.

On April 26, 2007, Baker Hughes Inc. settled charges with the SEC based on alleged violations of the FCPA and agreed to pay the largest FCPA penalty to date.[2] The total monetary sanction of $44.1 million included a $10 million civil penalty for violating a 2001 cease-and-desist order and $23 million in disgorgement and prejudgment interest, and $11 million as a criminal fine. According to the SEC, Baker Hughes paid approximately $5.2 million to two agents with the knowledge that some or all of the money was intended to bribe government officials in order to procure business. The SEC also alleged violations of the books and records and internal controls provisions of the FCPA for failing to determine whether the payments were for legitimate services, whether the payments would be shared with government officials, and whether the payments would be accurately recorded in Baker Hughes' books and records. Baker Hughes consented to the entry of a final judgment permanently enjoining it from future violations of Sections 30A, 13(b)(2)(A), 13(b)(2)(B), and 13(b)(5) of the Exchange Act, and also entered into a deferred prosecution agreement with the DOJ requiring the payment of a criminal fine of $11 million and retention of a compliance monitor.

The SEC also charged Roy Fearnely, a former business development manager for Baker Hughes, with violating and aiding and abetting violations of the FCPA. Fearnley is contesting the SEC's charges.

C. Textron, Inc.

On Aug. 23, 2007, the SEC filed settled FCPA charges against Textron, Inc. alleging that from 2001 to 2003, two of Textron's French subsidiaries paid approximately $650,539 in kickbacks to Iraqi-controlled accounts in connection with the sale of humanitarian goods to Iraq as part of the U.N. Oil for Food program.[3] The SEC also alleged that from 2001 to 2005, Textron's subsidiaries made improper payments of $114,995 to secure contracts in Bangladesh, Egypt, India, Indonesia and the United Arab Emirates. Without admitting or denying the SEC's allegations, Textron consented to a permanent injunction from future violations of Sections 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act, disgorgement of approximately $2.7 million and a civil penalty of $800,000. Textron also agreed to pay a $1.15 million fine pursuant to a non-prosecution agreement with DOJ.

D. Bristow Group Inc.

On Sept. 26, 2007, the SEC instituted a settled administrative proceeding against Bristow Group Inc., alleging that a company affiliate made improper payments of approximately $423,000 during 2003 and 2004 to Nigerian government officials to secure a reduction of employment taxes.[4] The SEC's Order also stated that the same Bristow affiliate, along with another Nigerian affiliate, underreported their expatriate payroll expenses in Nigeria. The SEC charged Bristow with maintaining insufficient controls and mischaracterizing the payments to state government officials as legitimate payroll expenses. Without admitting or denying the allegations, Bristow agreed to cease and desist from committing violations of the anti-bribery, internal controls and books and records provisions of the Exchange Act.

E. Chevron Corp.

On Nov. 14, 2007, the SEC filed settled FCPA books and records and internal controls charges against Chevron Corp.[5] The SEC alleged that from approximately April 2001 through May 2002, Chevron contracted with third parties who, in connection with Chevron's purchases of crude oil under the U.N. Oil for Food Program, made approximately $20 million in illegal kickback payments to Iraqi officials. The kickbacks were paid in spite of a company-wide policy implemented by Chevron in January 2001 prohibiting the payment of surcharges in connection with the purchase of Iraqi oil from third parties.

Chevron, without admitting or denying the allegations in the SEC's complaint, consented to the entry of a final judgment permanently enjoining it from future violations of Sections 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act, and $30 million in monetary sanctions, including disgorgement of $25 million and a civil penalty of $3 million. Chevron also agreed to pay the Office of Foreign Asset Controls of the U.S. Department of Treasury a penalty of $2 million. Chevron also agreed that its $25 million disgorgement obligation would be satisfied by forfeiting $20 million pursuant to an agreement with the U.S. Attorney's Office for the Southern District of New York and paying disgorgement of $5

[1] Litigation Release No. 19991 (Feb. 7, 2007) (www.sec.gov/litigation/litreleases/lr19991.htm).

[2] www.sec.gov/news/press/2007/2007-77.htm.

[3] Litigation Release No. 20251 (August 23, 2007) (www.sec.gov/litigation/litreleases/2007/lr20251.htm).

[4] www.sec.gov/news/press/2007/2007-201.htm.

[5] www.sec.gov/news/press/2007/2007-230.htm.

million pursuant to an agreement with the Manhattan District Attorney's Office.

F. Robert W. Philip.

On Dec. 13, 2007, the SEC filed a settled civil injunctive action against Robert W. Philip, the former Chairman and Chief Executive Officer of Schnitzer Steel Industries, Inc., for violating FCPA anti-bribery provisions by approving cash payments and other gifts to officials at Chinese government-owned steel mills.[6] The SEC alleged that from at least 1999 through 2004, Philip authorized payment of more than $200,000 in cash bribes and other gifts to managers at Chinese government-owned steel mills in order to induce them to purchase scrap metal from Schnitzer, and alleged that Schnitzer generated more than $96 million in revenue and more than $6.2 million in profits from sales to customers who had received the improper payments. The SEC further alleged that Philip authorized more than $1.7 million in payments to managers of privately owned steel mills in both China and South Korea, generating more than $500 million in additional revenue for the company. Without admitting or denying the allegations, Philip consented to an injunction and agreed to disgorge $169,863.79 in bonuses and pay $16,536.63 in prejudgment interest, as well as a $75,000 civil penalty.[7]

2. Options Backdating Cases. During 2007, the SEC investigated more than 160 companies and their executives for improperly ''backdating'' options, a practice which the SEC alleged provided a compensation windfall to executives and concealed the compensation expense from shareholders. Charges were brought against more than two dozen companies and executives for allegedly looking back and selecting a grant date when the stock price was low, and then falsely documenting the grant as if the action had occurred on that date. While the SEC settled a number of cases involving alleged intentional conduct to falsify option grants, more than 80 cases remained open in the first quarter of 2008.[8] According to Linda Thomsen, Director of the SEC's Division of Enforcement, the SEC would like to determine ''in relatively short order'' whether to seek sanctions in the outstanding cases.[9]

The following are the most significant of the options backdating cases brought in 2007:

A. William F. Sorin.

On Jan. 10, 2007, William Sorin, the former General Counsel of Comverse Technology, Inc., settled charges with the SEC regarding his role in alleged options backdating.[10] The SEC accused Sorin of falsely creating company records to evidence options grants when in fact no corporate action had occurred. Sorin agreed to a permanent officer-and-director bar, a permanent injunction against future violations and to over $3 million in civil penalties, disgorgement and pre-judgment interest, of which more than $1 million represented the ''in-the-money'' benefit from options he exercised. Sorin also consented to the entry of an administrative order pursuant to Rule 102(e) of the SEC's Rules of Practice suspending him from appearing or practicing before the SEC as an attorney. Pursuant to an agreement with the U.S. Attorney's Office for the Eastern District of New York, Sorin also agreed to plead guilty to one count of conspiracy to commit securities fraud, mail fraud, and wire fraud.

B. Gary C. Gerhardt and Steven J. Landmann.

On Feb. 6, 2007, the SEC filed civil injunctive charges against Gary C. Gerhardt and Steven Landmann, respectively, the former CFO and former Controller of Engineered Support Systems Inc.[11] The SEC alleged that from 1997 through 2002, Landmann backdated options at the instruction of Gerhardt, and that Gerhardt ordered Landmann to cancel previously issued options that had fallen ''out-of-the-money'' and to reissue them with new backdated grant dates and exercise prices, to bring them back ''in-the-money.'' The SEC further alleged that Gerhardt directed Landmann to issue additional options to nonemployee directors in excess of authorized amounts, from which these directors received a total gain of approximately $6 million. According to the SEC, Engineered Support purportedly overstated its aggregate pretax operating income by approximately $26 million, or 21 percent, for fiscal years 1997 through 2002. Without admitting or denying the allegations, Landmann consented to a permanent officer-and-director bar, disgorgement of more than $518,000, prejudgment interest of $108,099, and a civil penalty of $259,486. Gerhardt is contesting the charges.

C. Ryan Ashley Brant.

On Feb. 14, 2007, Ryan Ashley Brant, founder and former Chief Executive Officer of Take-Two Interactive Software, Inc., settled charges with the SEC that between 1997 and 2003 Brant enriched himself and others by granting undisclosed ''in-the-money'' stock options to himself and other officers and employees.[12] The SEC alleged that Brant directed officers and employees to create documents falsely indicating grant dates and that he personally received 2.1 million backdated options, all of which he exercised before resigning in October 2006. Without admitting or denying the allegations, Brant agreed to disgorge $4.1 million in ill-gotten gains, plus $1.1 million in prejudgment interest, a $1 million civil penalty and a permanent officer and director bar. Additionally, Brant pled guilty to a felony charge of falsifying business records in a New York state court proceeding and agreed to pay $1 million in lieu of fines and forfeiture.

D. Myron F. Olesnyckyj.

On March 27, 2007, Myron Olesnyckyj, former General Counsel of Monster Worldwide, Inc., settled charges filed by the SEC on Feb. 15, 2007, alleging that Olesnyckyj, or others acting at his direction, prepared false documentation indicating option grants were made on selected low price dates from 1997 to 2003.[13]

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[6] Litigation Rel. No. 20397 (Dec. 13, 2007) (www.sec.gov/litigation/litreleases/2007/lr20397.htm).

[7] In October 2006, Schnitzer paid $7.7 million in disgorgement and interest and agreed to retain a compliance consultant to settle related charges by the SEC. www.sec.gov/litigation/admin/2006/34-54606.pdf.

[8] David Evans & David Scheer, SEC Aims to End Backdating Cases in 'Short Order' Thomsen Says, Bloomberg (Jan. 25, 2008) (available at http://www.bloomberg.com/apps/news?pid=email_en&refer=home&sid=avxEFbA2CFfs).

[9] *Id.*

[10] Litigation Rel. No. 19964 (Jan. 10, 2007) (www.sec.gov/litigation/litreleases/2007/lr19964.htm).

[11] Litigation Release No. 19990 (Feb. 6, 2007) (www.sec.gov/litigation/litreleases/2007/lr19990.htm).

[12] Litigation Rel. No. 20003 (Feb. 14, 2007) (www.sec.gov/litigation/litreleases/lr20003.htm).

[13] Litigation Rel. No. 20056 (March 27, 2007) (www.sec.gov/litigation/litreleases/lr20056.htm).

The SEC alleged that Olesnyckyj's actions caused Monster to misrepresent in its public filings that the stock options were granted at the fair market value on the date of the award, which caused Monster to overstate its income by $340 million from 1997 through 2005. Without admitting or denying the allegations, Olesnyckyj consented to a permanent injunction and a permanent officer-and-director bar. Olesnyckyj also pled guilty to one count of securities fraud and one count of conspiracy to commit securities fraud in a parallel criminal proceeding, agreeing to a forfeiture of $381,000.

E. Nancy R. Heinen and Fred D. Anderson.

On April 24, 2007, the SEC filed stock option backdating charges against two former senior executives of Apple, Inc., Nancy R. Heinen, Apple's former General Counsel and Fred Anderson, Apple's former Chief Financial Officer.[14] The SEC alleged that Heinen participated in fraudulently backdating options grants to Apple's top officers and caused Apple to underreport $40 million in expenses, and that Anderson failed to disclose key information to Apple's auditors and additionally failed to ensure the accuracy of Apple's financial statements. Without admitting or denying the allegations, Anderson agreed to a permanent injunction and to disgorge approximately $3.5 million, including prejudgment interest, and to pay a $150,000 civil penalty. Heinen is contesting the charges.

F. Brocade Communications Systems, Inc.

On May 31, 2007, Brocade Communications System, Inc. agreed to pay the SEC a $7 million civil penalty to settle charges that it committed fraud through its former Chief Executive Officer and other high-level management.[15] The SEC alleged that Brocade's former Chief Executive Officer Gregory Reyes granted ''in-the-money'' options to employees, permitting the company to conceal millions of dollars in compensation expenses.[16] The SEC further alleged that former executives prepared documents that falsely indicated that options had been granted at an earlier date when the stock price was lower.

G. Mercury Interactive, LLC, et al.

On May 31, 2007, Mercury Interactive, LLC (formerly known as Mercury Interactive Corp.) agreed to a $28 million dollar civil penalty and a permanent injunction to settle options backdating charges.[17] The SEC alleged the company backdated every grant made by the company to executives and employees from 1997 to 2002. The SEC also brought charges against four former high-ranking executives at the company, including Chairman and Chief Executive Officer Amnon Landan, former Chief Financial Officers Sharlene Abrams and Douglas Smith, and former General Counsel Susan Skaer, which remain pending.

H. Integrated Silicon Solution, Inc. and Gary L. Fischer.

On Aug. 1, 2007, the SEC settled charges with Integrated Silicon Solutions, Inc. (''ISSI'') and its former Chief Financial Officer, Gary Fischer. The SEC alleged that between 1997 and 2005, Fischer backdated option grant dates which were then falsely incorporated into Stock Option Committee resolutions and Compensation Committee meeting minutes in an attempt to make it appear that the grants were actually made on the selected dates. The SEC alleged that this action caused ISSI to materially misstate its finances. Without admitting or denying the allegations, ISSI and Fischer agreed to permanent injunctions. Fischer also agreed to a five-year officer-and-director bar and to pay disgorgement and interest in the amount of $414,830, as well as a civil penalty of $125,000.

I. Maxim Integrated Products, Inc., John F. Gifford and Carl W. Jasper.

On Dec. 4, 2007, the SEC filed actions against Maxim Integrated Products, Inc., and two former officers, alleging options backdating from 2000 to 2005.[18] Maxim and John F. Gifford, former President, CEO, and Chairman of the Board of Maxim, settled the charges, while Carl W. Jasper, former CFO, is contesting the charges. Without admitting or denying the allegations, Maxim and Gifford agreed to permanent injunctions. Gifford also agreed to disgorgement of a portion of his bonuses, plus interest, for a total of approximately $650,000, and a $150,000 civil penalty.

J. William W. McGuire, M.D.

On Dec. 6, 2007, the SEC entered into a ''record'' $468 million settlement with Dr. William W. McGuire, former Chief Executive Officer and Chairman of the Board of United Health Group Inc.[19] The SEC alleged that McGuire signed and approved documents that falsely evidenced grant dates at historically low prices, causing the company to overstate compensation expense by more than $1.526 billion between 1994 and 2005. The SEC further alleged that McGuire personally benefited from the backdating.

Without admitting or denying the SEC's allegations, McGuire agreed to disgorge almost $11 million, with approximately $1.7 million in prejudgment interest. McGuire also agreed to pay a $7 million civil penalty and to return to United Health all incentive and equity-based compensation he received from 2003 through 2006, totaling almost $448 million. McGuire's forfeiture of compensation was the first of its kind under the ''clawback'' provision of Section 304 of the Sarbanes-Oxley Act. McGuire also agreed to a permanent injunction as well as a 10-year officer-and-director bar.

3. Safeco Ins. Co. of America v. Burr Calls Interpretation of ''Willfulness'' Into Question. In *Safeco Ins. Co. of America v. Burr*,[20] the Supreme Court reviewed the construction of ''willfulness'' in determining the scienter requirement for a civil violation of the Fair Credit Reporting Act. The Supreme Court held that ''where willfulness is a statutory condition of civil liability,'' it encompasses knowing and reckless violations of a standard: ''This construction reflects common law usage,

[14] Litigation Rel. No. 20086 (Apr. 24, 2007) (www.sec.gov/litigation/litreleases/lr200086.htm).

[15] Litigation Rel. No. 20137 (May 31, 2007) (www.sec.gov/litigation/litreleases/lr20137.htm).

[16] Reyes received a 21-month prison sentence after a jury convicted him of 10 counts of securities fraud in connection with his role in the options granting at Brocade. Justin Scheck and Steve Stecklow, *Brocade Ex-CEO Gets 21 Months in Prison*, Wall. St. J., Jan. 17, 2008, at A3.

[17] Litigation Rel. No. 20136 (May 31, 2007) (www.sec.gov/litigation/litreleases/lr20136.htm).

[18] Litigation Release No. 20381 (Dec. 4, 2007) (www.sec.gov/litigation/litreleases/2007/lr20381.htm).

[19] Litigation Rel. No. 20387 (Dec. 6, 2007) (www.sec.gov/litigation/litreleases/2007/lr20387.htm).

[20] 127 S. Ct. 2201, 2208 (2007).

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which treated actions in 'reckless disregard' of the law as 'willful' violations.''[21]

Courts have already adopted the *Safeco* standard in contexts outside the Fair Credit Reporting Act. For example, in *In re Seagate Technology, LLC*,[22] a patent infringement action, the Federal Circuit overruled a prior holding that ''set a lower threshold for willful infringement that [was] more akin to negligence,'' in favor of the standard set forth in *Safeco*.[23] Noting that ''civil law generally calls a person reckless who acts in the face of an unjustifiably high risk of harm that is either known or so obvious that it should be known,'' the Court held that, in order to prove willful infringement, the patentee must show ''that the infringer acted despite an objectively high likelihood that its actions constituted infringement of a valid patent.''[24]

A number of provisions of the federal securities statutes include ''willfulness'' as a predicate for SEC sanctions. The Supreme Court's decision in *Safeco* calls into question the standard repeatedly articulated by the SEC and set forth in numerous decisions that ''willfulness'' in the context of a securities violation merely requires that the respondent intentionally commit the act which constitutes the violation. *See, e.g., Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000). To date, the SEC has not addressed this issue.

4. The SEC Continues to Struggle With Corporate Penalties Since the SEC's Jan. 4, 2006 Statement Concerning Financial Penalties,[25] the SEC and its staff have grappled with the question of the appropriateness of assessing civil money penalties against public companies. On April 13, 2007, SEC Chairman Christopher Cox announced a policy requiring SEC staff members to seek Commission approval of a range of possible settlement amounts before initiating settlement discussions when the settlement might involve a monetary penalty against a company.[26] If the negotiated penalty is within the approved range, the final settlement would then be approved through the SEC's seriatim procedure.

In October 2007, the SEC announced its first assessment of a corporate penalty under the April 2007 policy: Nortel Networks settled accounting fraud charges by agreeing to a permanent injunction and a penalty of $35 million. According to the SEC's allegations, beginning in late 2000, Nortel changed its revenue recognition policy so that it was not in accordance with GAAP. Among other things, the SEC alleged that Nortel accelerated revenue into 2000 in order to meet its announced revenue targets for the quarter and the year, inflating Nortel's revenues for fourth quarter and fiscal year 2000 by approximately $1.4 billion. In addition, the SEC charged that Nortel had manipulated reserves in 2002 and 2003, resulting in higher bonus payments to a select group of senior managers. Nortel agreed to a settlement without admitting or denying the SEC's allegations.[27]

On June 18, 2007, Bloomberg News had reported that the SEC approved a settlement range for the Nortel matter in May 2007, with a maximum amount set at approximately $100 million.[28] Nortel's ultimate settlement with the SEC included a $35 million penalty. However, on Oct. 15, 2007, the same day that the settlement was announced, Commissioner Atkins issued an email statement in which he criticized the fine and questioned the appropriateness of civil monetary penalties against corporations. He stated that the settlement ''does nothing to further the SEC's objectives'' of protecting investors and ''maintaining fair, orderly and efficient markets.'' He added that the fine ''will be paid by Nortel shareholders, many of whom were victims of the financial fraud.''[29]

5. First SARS Case. On Dec. 5, 2007, the SEC brought and settled its first case against a broker-dealer for failure to file Suspicious Activity Reports (''SARs''), which have been called ''one of the government's main weapons against money laundering and other financial crimes.''[30] The SEC's order against Florida-based broker-dealer Park Financial Group, Inc. and its principal, Gordon Cantley,[31] found that Park Financial Group and Cantley aided and abetted a pump-and-dump scheme involving the securities of Spear & Jackson, Inc. and failed to file SARs with respect to events related thereto. In particular, the Order found that Park Financial Group and Cantley executed trades despite obvious red flags that should have suggested the transactions involved conduct that required the firm to generate and file SARs.

Park Financial Group and Cantley were ordered to cease and desist from committing or causing violations of Sections 10(b) and 17(a) of the Exchange Act, as well as Rules 10b-5 and 17a-8. Additionally, Cantley was

[21] *Id.*

[22] 497 F.3d 1360 (Fed. Cir. 2007).

[23] *Id.* at 1371.

[24] *Id.*

[25] www.sec.gov/news/press/2006-4.htm.

[26] Chairman Christopher Cox, *Speech by SEC Chairman: Address to the Mutual Fund Directors Forum Seventh Annual Policy Conference* (Apr. 13, 2007) (available at http://www.sec.gov/news/speech/2007/spch041207cc.htm).

[27] Litigation Release No. 20333 (Oct. 15, 2007) (www.sec.gov/litigation/litreleases/lr20333.htm).

[28] Jesse Westbrook & Otis Bilodeau, SEC Chief Cox, Seeking Consensus, Draws Fire From Both Sides, Bloomberg.com (June 18, 2007) (available at http://www.bloomberg.com/apps/news?pid=20601103&sid=ax1WWAMfrL6A&refer=us).

[29] David Scheer, Nortel Pays $35 Million to End SEC Accounting Probe, Bloomberg.com (Oct. 15, 2007) (available at http://www.bloomberg.com/apps/news?pid=newsarchive&sid=azkwQVObIT10).

[30] *See* Internal Revenue Service's web page on Suspicious Activity Reports (located at http://www.irs.gov/businesses/small/article/0,,id=154555,00.html).

[31] *In the Matter of Park Financial Group, Inc. and Gordon C. Cantley*, Sec. Exch. Act Rel. No. 56902 (Dec. 5, 2007) (available at http://www.sec.gov/litigation/admin/2007/34-56902.pdf).

barred from association with a broker or dealer with a right to reapply after two years, was ordered to pay disgorgement and prejudgment interest in the amount of $8,429.71, and was required to pay a civil penalty in the amount of $25,000. Park Financial Group was censured, ordered to pay disgorgement and prejudgment interest in the amount of $30,373.39, and was required to pay a civil penalty of $50,000.

6. Administrative Actions Against 69 Auditors For Failing To Register with PCAOB. On Sept. 13, 2007, the SEC charged 37 audit firms and 32 partners for issuing audit reports for public companies without being registered with the Public Company Accounting Oversight Board.[32] Of those charged, 28 firms and 22 partners agreed to settlements in 29 separate administrative proceedings, requiring that they cease and desist from unregistered auditing activity and consent to the entry of an order finding that they had violated Section 102(a) of the Sarbanes-Oxley Act.[33] Two firms also agreed to disgorge audit fees received while unregistered. The SEC also instituted 10 separate proceedings against nine firms and 10 partners who contested the SEC's allegations.

7. Charges Against Outside Counsel in Connection with Refco Collapse. Consistent with the trend of increasing numbers of enforcement actions against attorneys, in December 2007, Joseph Collins was charged, both criminally and civilly, in connection with the collapse and subsequent bankruptcy of Refco, a financial services and commodities brokerage firm that provided execution and clearing services.[34] Collins, the former head of the derivatives practice group at Mayer Brown LLP, had represented the now-defunct company for over a decade, both at Mayer Brown and at his previous law firm.

The SEC alleged that Collins assisted in concealing Refco's debt of over $1 billion with a series of ''round trip'' transactions with Refco Group Holdings, Inc.[35] In addition, the SEC alleged that Collins worked on other related party transactions that occurred at the ends of Refco's fiscal periods in order to conceal Refco's debts. Refco and Collins allegedly made false representations to a private equity firm purchasing a controlling interest in Refco, to its external auditors, and in its IPO filings. The SEC is seeking a permanent injunction enjoining Collins from violating Section 10(b) of the Exchange Act and Rule 10b-5, as well as civil monetary penalties. Collins was also indicted on 11 counts, including fraud and false filing violations, based largely on the same conduct as alleged by the SEC.[36]

8. Court Rebuffs SEC's Argument that Covering Short Positions With PIPE Stock Violates Section 5 of the Securities Act. On Oct. 24, 2007, a district court rejected SEC arguments that covering short positions with stock obtained in Private Investment in Public Equity (''PIPE'') transactions violates Section 5 of the Securities Act.

In *SEC v. Mangan*, Civ. A. No. 06-CV-531 (W.D.N.C. filed Dec. 28, 2006), the SEC alleged that John F. Mangan, a broker employed by Friedman, Billings, Ramsey & Co., Inc. (''FBR''), had engaged in the sale of unregistered securities of CompuDyne Corp. through the account of his business partner. Prior to the announcement of a PIPE offering for which FBR was the placement agent, Mangan had allegedly engaged in short sales of CompuDyne stock, which he then covered using shares obtained in the PIPE transaction. The SEC argued that these activities constituted a sale of unregistered stock in violation of Section 5. On Oct. 24, 2007, the court dismissed the SEC's claims with regard to Section 5, noting that the counterparty in a short sale contracted for CompuDyne shares and ultimately received properly registered CompuDyne shares, regardless of the source. The court did not at the time dismiss related claims of insider trading, which were premised on alleged misappropriation of confidential information about the existence of the PIPE offering, through short sales occurring before public announcement of the PIPE offering.[37]

9. Market Timing and Late Trading Cases. In 2007, the SEC continued to pursue numerous cases against broker-dealers and investment advisors, registered representatives and their supervisors, who were alleged to have utilized deceptive practices to effect trades that mutual funds' stated policies or the federal securities laws. A potentially significant development occurred in a case against registered representatives in *In re Michael Sassano, et al.*

On Jan. 31, 2007, the SEC instituted public administrative and cease-and-desist proceedings against Michael Sassano, Dogan Baruh, Robert Okin, and R.

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[32] www.sec.gov/news/press/2007-183.htm.

[33] 15 U.S.C. § 7212.

[34] *SEC v. Joseph P. Collins*, Litigation Rel. No. 20402 (Dec. 18, 2007) (available at http://www.sec.gov/litigation/litreleases/2007/lr20402.htm).

[35] *SEC v. Joseph P. Collins*, 07 CV 11343 (S.D.N.Y. Dec. 18, 2007) (available at http://www.sec.gov/litigation/complaints/2007/comp20402.pdf).

[36] *United States v. Joseph P. Collins*, CR 1170 (S.D.N.Y. Dec. 18, 2007) (available at http://www.usdoj.gov/usao/nys/pressreleases/December/07collinsrefcoindictment.pdf).

[37] Similarly, in *SEC v. Lyon*, Civ. A. No. 06-CV-14338 (S.D.N.Y., filed Dec. 12, 2006), the SEC accused the defendants Edwin Buchanan Lyon IV and a number of entities of which he was the managing partner and chief investment officer, collectively termed ''Gryphon Partners,'' of violating Section 5 by shares resulting from a PIPE offering to cover short sales made before the registration statement for the PIPE shares became effective. In an opinion issued on Jan. 2, 2008, the court found, as did the court in *Mangan*, that using formerly-restricted PIPE shares to cover a short position did not convert the underlying short sale into a sale of unregistered PIPE shares, and that as a result, there was no Section 5 violation. The court also noted that the SEC's reasoning did not further the purposes of Section 5 of the Securities Act, because the counterparties in the short sales were in possession of all the information to which they had been entitled under Section 5. Again, however, the court did not dismiss the SEC's insider trading claims. More recently, in *SEC v. Berlacher*, Civ. A. No. 07-cv-3800 (ER) (E.D.Pa., filed Sept. 13, 2007), the SEC accused Robert Berlacher; Lancaster Investment Partners, L.P.; Northwood Capital Partners, L.P.; Cabernet Partners, L.P.; Chardonnay Partners, L.P.; Insignia Partners, L.P.; VFT Special Ventures, Ltd.; LIP Advisors, LLC; NCP Advisors, LLC; and RAB Investment Company, LLC of violations of Section 5 by using shares resulting from the PIPE to cover short positions. Despite new arguments apparently introduced in response to the decision in *Mangan* and *Gryphon*, the court reached the same result as the courts in prior cases, and dismissed the SEC's Section 5 claims on Jan. 25, 2008. *See* Order in *SEC v. Berlacher*, Civ. A. No. 07-cv-3800 (ER) (E.D.Pa., Feb. 5, 2008) (Docket No. 32).

Scott Abry.[38] According to the SEC, Sassano and Baruch, former registered representatives at CIBC World Markets Corp. and Fahnestock & Co., Inc., collaborated with hedge fund customers to deceptively market time mutual funds while Abry, their branch manager, and Okin, their direct supervisor, knowingly facilitated the conduct. Because mutual funds repeatedly complained of their abusive market timing trading, Sassano and Burch used several strategies to ''stay under the radar'' of the mutual funds' internal timing monitors. Such strategies included the creation and use of multiple accounts, multiple registered representative numbers, multiple branch numbers, smaller dollar amount trades, accounts at other broker-dealers, and variable annuities.

On June 8, 2007, the administrative law judge ordered the Division of Enforcement to provide respondents with access to all relevant, non-privileged evidence that had been gathered pursuant to the SEC's ''omnibus'' formal order of investigation which had been used as the order of investigation for all of the SEC's market-timing and late trading investigations. The Division of Enforcement requested interlocutory review but the request was denied by the SEC in an opinion dated Nov. 30, 2007.[39] The case is still pending.

Because of the Commission's ruling in Sassano requiring the production of all evidence gathered pursuant to an omnibus formal order, it is likely that the SEC Staff will discontinue the use of such orders of investigation and instead seek specific SEC authorization for each investigation.

10. Virginia Venue is Appropriate Based on SEC Computer in Virginia. On Dec. 14, 2007, the U.S. Court of Appeals for the Fourth Circuit held that PurchasePro Inc.'s founder and former Chief Executive Officer, Charles Johnson, is subject to prosecution in the Eastern District of Virginia, based on the fact that Johnson allegedly caused the filing of a false and fraudulent document with the SEC.[40] The court found that the Eastern District of Virginia is an appropriate forum to hear cases alleging securities fraud based on such filings, regardless of whether the person filing the documents could have reasonably foreseen that they would be routed through the agency's EDGAR computer servers in Alexandria, Virginia.[41] Additionally, the court determined that venue in securities prosecutions is not limited to locations where the ''essence'' of the offense took place, but rather includes any locations where a material act took place.[42] While the transmission in this case was sufficient to establish venue in the Eastern District, the court emphasized that its decision did not mean that ''all securities fraud prosecutions based on the filing of fraudulent documents through EDGAR *must* take place where the EDGAR server is located.''[43] Rather, the Eastern District is ''one permissible venue.''[44]

[38] Securities Act Rel. No. 8778 (Jan. 31, 2007).

[39] Securities Act Rel. No. 8865 (Nov. 30, 2007) (www.sec.gov/litigation/opinions/33-8865.pdf).

[40] *United States v. Johnson*, 510 F.3d 521, 522 (2007).

[41] *Id.* at 526-527.

[42] *Id.* at 524-525.

[43] *Id.* at 528.

[44] *Id.*