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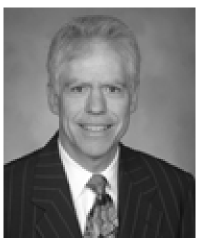
ENFORCEMENT

Top Ten SEC Enforcement Developments of 2012



BY MARC DORFMAN AND ELLEN WHEELER

This article highlights significant developments during 2012 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.

Last year we highlighted as the Number One enforcement development of 2011 the increasing scrutiny by courts of settlements negotiated between the SEC and defendants. As we noted a year ago,

> The U.S. Court of Appeals for the Second Circuit is considering an appeal by the SEC from a decision issued by U.S. District Court Judge Jed S. Rakoff rejecting a settlement negotiated by the SEC with Citigroup Capital Markets as "neither reasonable, nor fair, nor adequate, nor in the public interest" because it "asks the Court to impose substantial injunctive relief, enforced by the Court's own contempt power, on the basis of allegations unsupported by any proven or acknowledged facts whatsoever. . . ." The SEC has asked the Second Circuit to reject Judge Rakoff's approach, but if its appeal is unsuccessful, the SEC will have little choice but to revisit its practices in negotiating settlements.

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In some ways, during 2012, SEC Enforcement developments were reminiscent of a Beckett play, but with a new title: "Waiting for Rakoff." The appeal to the Second Circuit from Judge Rakoff's order declining to approve a settlement between the SEC and Citigroup remains sub judice, with the Court having finally heard oral argument on February 8, 2013. The outcome of that appeal is expected to have a significant impact on the SEC's practices in negotiating settlements, either in confirming or limiting the use of consents which "neither admit nor deny" the SEC's allegations.

In November 2012, the SEC announced that it had filed 734 enforcement actions in the fiscal year ending September 30 (only one fewer than the record number of proceedings instituted in the prior year).[1] Many of these actions are reflective of much larger societal trends. For example, this year's Top Ten reflects the growing significance of social media and the increased globalization of markets, particularly with respect to China.

The Number One enforcement development of 2012 is the SEC's increasing effort to hold individuals (as well as their corporate employers) accountable for violations, with occasionally mixed results. Undoubtedly in response to the clamor of media and congressional complaints that executives at banks and other financial institutions have not been held responsible for the conduct that led to the 2008 financial crisis and market collapse, the SEC heavily touted its actions against bankers and other individuals during 2012. The SEC, however, also suffered a number of setbacks in its efforts to pursue such individuals in 2012. Indeed, the SEC's case against a midlevel Citigroup executive resulted in both a defense verdict and a public rebuke by the jury foreman that the SEC had not pursued the top executives.

The SEC and the U.S. Department of Justice are jointly responsible for enforcing the provisions of the

[1] SEC's Enforcement Program Continues to Show Strong results in Safeguarding Investors and Markets, Release No. 2012-227 (Nov. 14, 2012).

Foreign Corrupt Practices Act of 1977 (''FCPA''). The Number Two enforcement development of 2012 is the joint release by the SEC and DOJ in November of ''A Resource Guide to the U.S. Foreign Corrupt Practices Act,'' a 120-page guide providing a detailed analysis of the SEC's and DOJ's approaches to FCPA enforcement.

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

- Number Three is the Supreme Court's grant of a writ of certiorari in 2012 and decision in February 2013 holding that the five-year clock in the statute of limitations applicable to SEC claims for fraud begins when the fraud occurs, not when it is discovered.

- The Number Four enforcement development of 2012 is the SEC's continued aggressive pursuit of insider trading cases.

- Number Five is the easing of the standard for aiding and abetting liability by the Second Circuit.

- Number Six is the opening for business of the SEC's whistleblower program.

- Number Seven is the SEC's pursuit of cases against officers and directors for overvaluing their firms' assets.

- Number Eight is the SEC's case against a ''dark pool'' for not being dark enough.

- Number Nine is the SEC's pursuit of cases involving pre-IPO trading.

- Number Ten is the SEC's initiation of enforcement proceedings against China-based affiliates of U.S. accounting firms.

1. The SEC's Increasing Pursuit of Individuals, With Mixed Results

In its press release describing its enforcement results in 2012, the SEC touted its enforcement actions against individuals accused of wrongdoing related to the financial crisis.[2] The SEC pointed out that it had filed 29 separate actions against 34 individuals, including 24 CEOs, CFOs and other senior corporate officers. Outgoing Chairman Mary L. Schapiro similarly focused on the SEC's pursuit of individuals during her speech at the 2012 New England Securities Conference, explaining that the SEC is ''determined in our pursuit of those whose actions fueled the Financial Crisis, bringing actions against over 100 individuals and firms – including more than 50 CEOs, CFOs and other senior officers, and obtaining more than $2.2 billion in monetary relief – not to mention dozens of orders barring individuals from the financial industry.''[3]

Actions brought in 2012 against individuals accused of wrongdoing in connection with the financial crisis include the following:

- An action against four former investment bankers and traders at Credit Suisse Group for allegedly engaging in a complex scheme to fraudulently overstate the prices of $3 billion in subprime bonds during the height of the subprime credit crisis.[4]

- Actions against bank and mortgage executives accused of misleading investors about mounting loan losses and the deteriorating financial condition of their employers.[5]

- Actions against officers and directors accused of overvaluing their entities' assets.[6]

The SEC did not, however, have an entirely successful track record in 2012 in its pursuit of actions against individuals.

Most notably, on July 31, 2012, a jury found in favor of Brian Stoker, a midlevel executive at Citigroup and the only individual the SEC charged with wrongdoing in connection with Citigroup's sale of a $1 billion collateralized debt obligation.[7] The jury took the highly unusual step of issuing a statement with its verdict, explaining that ''[t]his verdict should not deter the S.E.C. from continuing to investigate the financial industry, review current regulations and modify existing regulations as necessary.''[8] And, if the jury verdict and statement were not enough to indicate that the jury believed that the SEC was not going after the right individuals, the jury foreman told the media following the trial that ''I wanted to know why the bank's C.E.O. wasn't on trial. . . . Citigroup's behavior was appalling.''[9]

Later in the year, the SEC suffered another high profile setback, this time in its effort to hold an individual accountable in connection with J.P. Morgan Securities' CDO offerings. On November 21, 2012, the SEC announced that it was dismissing with prejudice its complaint against Edward Steffelin, the only individual charged with wrongdoing in connection with a synthetic collateralized debt obligation (CDO), Squared CDO 2007-1, that J.P. Morgan structured and mar-

[2] SEC's Enforcement Program Continues to show Strong Results in Safeguarding Investors and Markets, Release No. 2012-227 (Nov. 14, 2012).

[3] Speech by Mary L. Schapiro, SEC Chairman, Remarks at 2012 New England Securities Conference (Oct. 11, 2012).

[4] SEC Charges Former Credit Suisse Investment Bankers in Subprime Bond Pricing Scheme During Credit Crisis, Release No. 2012-23 (Feb. 1, 2012).

[5] SEC Charges Bank Executives in Nebraska With Understating Losses During Financial Crisis, Release No. 2012-198 (Sep. 25, 2012); SEC Charges Texas Bank Holding Company's CEO and CFO with Misleading Investors About Loan Quality and Financial Health During the Financial Crisis, Release No. 2012-55 (Apr. 6, 2012); SEC Charges Three Mortgage Executives With Fraudulent Accounting Maneuvers in Midst of Financial Crisis, Release No. 2012-42 (Mar. 13, 2012).

[6] SEC Charges Hedge Fund Adviser and Two Executives With Fraud in Continuing Probe of Suspicious Fund Performance, Release No. 2012-209 (Oct. 17, 2002); *SEC v. Yorkville Advisors, LLC et al.*, Case No. 12 7728 (S.D.N.Y.); SEC Charges Eight Mutual Fund Directors for Failure to Properly Oversee Asset Valuation, Release No. 2012-259 (Dec. 10 2012).

[7] Peter Lattman, *A Jury's Message for Wall Street*, NY Times, at B1 (Aug. 4, 2012).

[8] *Id.*

[9] *Id.*

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keted.[10] The SEC had settled with J.P. Morgan[11] in June 2011 for a payment of $153.6 million.[12]

2. The Importance of an Effective FCPA Compliance Program Is Highlighted in the SEC And DOJ's Resource Guide to the U.S. Foreign Corrupt Practices Act and in Their Enforcement Practices

On November 14, 2012, the SEC announced that it and the Department of Justice had released a Resource Guide to the U.S. Foreign Corrupt Practices Act.[13] This 120-page document is non-binding and does not in any way ''limit the enforcement intentions or litigation positions'' of the DOJ or SEC. Nor does the guide contain much new information. The guide does, however, have value in that it collects a significant amount of information in one easily accessible document, including recent matters where the DOJ and SEC opted not to pursue penalties, and identifying what the SEC and DOJ consider to be ''hallmarks'' of effective FCPA compliance programs that will mitigate sanctions.

The SEC filed eight FCPA enforcement actions against corporate defendants in 2012, a significant decrease from the 13 actions filed in 2011.[14] The SEC also filed one action against one individual, down from three actions against nine individuals 2011.[15] The one individual action was against former Morgan Stanley executive, Garth R. Peterson. It is this action that highlights one of the most notable enforcement development in the FCPA area in 2012 – the lack of any enforcement action against Morgan Stanley.

In its action against Peterson, the SEC alleged that Peterson, a managing director in Morgan Stanley's real estate investment and fund advisory business, maintained a friendship and a secret business relationship with the former chairman of a Chinese state-owned entity and arranged to have at least $1.8 million paid to himself and the chairman that he disguised as finder's fees owed to third parties.[16] Peterson is also accused of arranging for himself, the chairman, and an attorney to acquire a valuable real estate interest from the fund. In return, the chairman helped Peterson and Morgan Stanley obtain business.

The SEC alleges that a Morgan Stanley compliance officer specifically informed Peterson in 2004 that employees of the Chinese state-owned entity were government officials for purposes of the FCPA and that Peterson received at least 35 FCPA compliance reminders from Morgan Stanley.

The Department of Justice, in announcing its parallel criminal action against Peterson, provided significantly more detail regarding Morgan Stanley's compliance program, almost effusively so.[17] The Department of Justice stressed that Morgan Stanley's internal policies were ''updated regularly,'' that Morgan Stanley ''frequently'' trained its employees on its internal policies, the FCPA and other anti-corruption laws, that Morgan Stanley conducted 54 training sessions of Asia-based personnel over a six-year period and Peterson himself was trained seven times, that Morgan Stanley regularly monitored transactions, randomly audited particular employees, transactions and business units, and tested to identify illicit payments, and that Morgan Stanley conducted ''extensive due diligence'' on all new business partners and imposed ''stringent controls'' on payments to business partners.

3. Supreme Court Agrees to Decide Applicability of 'Discovery Rule' to SEC Fraud Claims (and Does So in Early 2013)

In October 2012, the U.S. Supreme Court granted certiorari to review the Second Circuit's decision in *SEC v. Gabelli*.[18] In doing so, the Supreme Court agreed to decide the question of when an action ''accrues'' for purposes of the five-year statute of limitations that applies to civil enforcement actions and, more specifically, whether the ''discovery rule'' applies to fraud claims brought by the SEC.

In *Gabelli*, the Second Circuit concluded that the five-year state of limitation set forth in 28 U.S.C. § 2462 does not bar an action based on fraud because such fraud claims do not ''accrue'' for purposes of the statute of limitations until the SEC discovers such claims. The Second Circuit reached this decision despite the fact that the plain language of 28 U.S.C. § 2462 does not provide for a discovery rule. The Second Circuit, however, concluded that a discovery rule must be read into any claims that ''sound in fraud'' because ''fraud claims by their very nature involve self-concealing conduct.''[19]

The Supreme Court granted certiorari to review *Gabelli* even though, at the time, there was no split in the Circuits. However, soon after the grant of certiorari in *Gabelli*, the Fifth Circuit reached the opposite conclusion. In an unpublished opinion, *SEC v. Bartek*,[20] the Fifth Circuit upheld the district court's dismissal of the SEC's claims against individuals accused of fraud backdating of options. The court concluded that the claims – brought more than five years after the alleged backdating took place – were barred by the five-year statute of limitations set forth in 28 U.S.C. § 2462. The court found that a ''plain reading of 2462 reveals no discovery rule exception.''[21]

Not only did the court conclude that the SEC's claim for a monetary penalty was barred as untimely, the

[10] District Court Dismisses Action Against Edward S. Steffelin, Lit. Release No. 22540 (Nov. 21, 2012).

[11] Steffelin did not work for J.P. Morgan, but for an investment advisory firm that served as collateral manager on the offering.

[12] J.P. Morgan Securities to Pay $153.6 Million to Settle SEC Charges of Misleading Investors in CDO Tied to U.S. Housing Market, Lit. Release No. 22008 (June 21, 2011).

[13] SEC and Justice Department Release FCPA Guide, Release No. 2012-225 (Nov. 14, 2012).

[14] SEC Enforcement Actions: FCPA Cases (available at http://www.sec.gov/spotlight/fcpa/fcpa-cases.shtml).

[15] *Id.*

[16] SEC Charges Morgan Stanley Executive With FCPA Violations and Investment Adviser Fraud, Release No. 2012-78 (Apr. 25, 2012).

[17] U.S. Dep't. of Justice, Press Release, Former Morgan Stanley Managing Director Pleads Guilty for Role in Evading Internal Controls Required FCPA (Apr. 25, 2012).

[18] 653 F.3d 49 (2nd Cir. 2011).

[19] *Id.* at 59.

[20] *SEC v. Bartek*, No. 11-10594, slip op. (5th Cir. Aug. 7, 2012) (*per curiam*, unpublished).

[21] *Id.* at 6.

Fifth Circuit also held that 28 U.S.C. § 2462 also barred the SEC's requests for injunctive relief and for officer/director bars. The court concluded that the requested relief was more punitive than remedial, noting ''[t]he SEC's sought-after remedies would have a stigmatizing effect and long-lasting repercussions'' while being unlikely to prevent future harm.[22]

As this article was going to press, on February 27, 2013, the Supreme Court issued its decision reversing the Second Circuit and concluding that the discovery rule does not extend to SEC civil penalty actions.[23]

4. The SEC's Continued Aggressive Pursuit of Insider Trading Cases

The SEC filed 58 insider trading cases in the fiscal year ending September 30, 2012, an increase of one case from the prior year.[24] As in prior years, these cases run the gamut from relative small ''one-offs''[25] to massive schemes involving insider trading networks.[26]

While the SEC continued to bring new cases, other earlier cases continued to work their way through the courts. The SEC received a welcome ruling from the Second Circuit in one long-running insider trading case involving trading in advance of Allied Capital Corporation's (''Allied'') acquisition of SunSource, Inc. (''SunSource'') in June 2001.

In *SEC v. Obus*,[27] the SEC alleged that Thomas Strickland, an assistant vice president and underwriter at General Electric Capital Corporation (''GE Capital''), was assigned to perform due diligence on SunSource, the subject of a proposed acquisition by Allied, a client of GE Capital. According to the SEC, Strickland told Peter Black, an analyst at Wynnefield Capital, Inc. (''Wynnefield''), about the SunSource/Allied acquisition. According to the defendants, Strickland spoke to Black as part of his due diligence efforts because he knew that Wynnefield was a large stakeholder in SunSource. Black asserts that, based on the questions asked of Strickland, he simply surmised that SunSource was about to be acquired. In either event, Black immediately told Nelson Obus, his boss and Wynnefield's principal.

Two weeks later, Wynnefield bought a large block of SunSource shares, amounting to about a five percent of SunSource. Allied announced it was acquiring SunSource eleven days later. SunSource's stock closed 91.5 percent higher than the day before, resulting in an unrealized profit of more than $1.3 million for Wynnefield.

In July and August 2002, the SEC subpoenaed Obus, Black and Strickland. After receiving the SEC's subpoena about SunSource, GE Capital conducted an internal investigation into Strickland's conduct. The investigation concluded that, although Strickland had disclosed information pertaining to SunSource outside of GE Capital, he did not discuss the nature of the specific transaction being contemplated. Strickland was reprimanded and denied a bonus and salary increase for his ''disregard'' of GE Capital's ''confidentiality restrictions,'' but he was not terminated.[28]

The SEC filed a civil complaint against Obus, Black and Strickland in 2006. In 2010, however, the district court granted defendants' summary judgment motion. The court found that, even if Strickland told Black material non-public information, the SEC had failed to establish a genuine issue of fact as to whether Strickland had breached a fiduciary duty to his employer, GE Capital. The district court's decision was based on the GE Capital's internal investigation which concluded that Strickland had not breached a duty to his employer and on the fact that SunSource was not placed on GE Capital's transaction restricted list until after the acquisition was announced.

The Second Circuit reversed, finding that the SEC had presented sufficient evidence to survive summary judgment. First, the court found that the fact that SunSource was not on the restricted list was not determinative because there was sufficient evidence that Strickland knew he was under an obligation to keep the information confidential, including the fact that every page of the deal book was marked ''Extremely Confidential.''

Second, the Second Circuit rejected the district court's reliance on GE Capital's internal investigation. The court pointed out that ''the GE investigation was motivated by corporate interests that may or may not coincide with the public interest in unearthing wrongdoing and affording a remedy.''[29] The court also noted that a jury must make its own independent assessment of the evidence and would not be bound by the conclusions of an internal investigation.

5. Second Circuit Eases Aiding and Abetting Standard

Last year's decision by the U.S. Supreme Court in *Janus Capital Group v. First Derivative Traders*[30] as to who constitutes a ''maker'' of a statement for purposes of Rule 10b-5 claims based on misrepresentations has undoubtedly forced that Division of Enforcement to assert more aiding and abetting claims in lieu of asserting primary violations. This year's decision by the Second Circuit in *SEC v. Apuzzo*[31] makes aiding and abetting claims an even more attractive option.

In *Apuzzo*, the Second Circuit overturned a district court decision dismissing the SEC's claim that Joseph Apuzzo had aided and abetted securities fraud by par-

[22] *Id.* at 12-13.
[23] *Gabelli v. SEC*, No. 11-1274, slip op. (Feb. 27, 2013).
[24] SEC's Enforcement Program Continues to Show Strong Results in Safeguarding Investors and Markets, Release No. 2012-227 (Nov. 14, 2012).
[25] *See, e.g.*, SEC Charges Research Analyst with Trading and Tipping Ahead of IBM-SPSS Merger, Release No. 2012-280 (Dec. 26, 2012); Brazilian Ex-Banker to Pay $5.1 Million for Insider Trading in Burger King Stock, Release No. 2012-248 (Nov. 30, 2012); SEC Charges Public Relations Executive With Insider Trading in Client's Stock, Release No. 2012-179 (Sept. 5, 2012).
[26] *See, e.g.*, SEC Charges 10 in Insider Trading Ring Around Investment Banker's Illegal Tips on Impending Mergers, Release No. 2012-255 (Dec. 5, 2012); SEC Charges Hedge Fund Firm CR Intrinsic and Two Others in $276 Million Insider Trading Scheme Involving Alzheimer's Drug, Release No. 2012-237 (Nov. 20, 2012); SEC Charges Ring of High School Buddies with Insider Trading in Health Care Stocks, Release No. 2012-234 (Nov. 19, 2012).
[27] 693 F.3d 276 (2d Cir. 2012).
[28] *Id.* at 283.
[29] *Id.* at 291.
[30] 131 S. Ct. 2296, 2301 (2011) (holding that the maker of a statement is the person or entity with ''ultimate authority'' over the statement, ''including its content and whether and how to communicate it.'').
[31] 689 F.3d 204 (2d Cir. 2012).

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ticipating in two ‘‘sale-leaseback’’ transactions designed to allow another company to recognize revenue prematurely and inflate profits. The district court concluded that the SEC had not adequately alleged that Apuzzo ‘‘substantially assisted’’ the fraud because the SEC had failed to show that Apuzzo had proximately caused the primary violation.

The Second Circuit, however, found that a showing of proximate cause was not required. Noting that it ‘‘welcome[d] the opportunity to clarify’’ the appropriate standard, the court pointed out that requiring a showing of proximate cause could mean that ‘‘many if not most aiders and abettors would escape all liability if such a proximate cause requirement were imposed, since, almost by definition, the activities of an aider and abettor are rarely the direct cause of the injury brought about by the fraud, however much they may contribute to the success of the scheme’’ and only the SEC may bring aiding and abetting claims for securities law violations.[32]

The court instead held that, in order to satisfy the ‘‘substantial assistance’’ component of aiding and abetting, the SEC need only show that ‘‘the defendant ‘in some sort associate[d] himself with the venture, that he participate[d] in it as in something that he wishe[d] to bring about, [and] that he [sought] by his action to make it succeed.’ ’’[33]

6. The SEC’s Whistleblower Program ‘Opens for Business’

On November 15, 2012, the SEC released its 2012 Annual Report on the Dodd-Frank Whistleblower Program.[34] The report revealed that the SEC’s Whistleblower Office had received 3001 tips in the 2012 fiscal year. Those tips came from individuals in all 50 states, the District of Columbia, Puerto Rico and 49 other countries.

Earlier in the year, on August 21, 2012, the SEC announced that it had paid its first award to a whistleblower under the new program.[35] According to the SEC, the individual received an award of $50,000 representing 30 percent of the amount collected in the action stemming from the information received from the whistleblower. In announcing the award, Sean McKessy, Chief of the SEC’s Whistleblower Office’’ stated that ‘‘[t]he fact that we made the first payment just one year of operation shows that we are open for business and ready to pay people who bring us good, timely information.’’[36]

7. SEC Charges Officers and Directors with Overvaluing Assets in Several Cases

As discussed above, 2012 saw a large number of actions against individuals arising out of the financial crisis. One area of particular focus was valuation of assets. In the last three months of 2012, the SEC brought three actions against officers and directors accused of overvaluing their firms’ assets.

First, on October 17, 2012, the SEC announced an action against the hedge fund advisory firm Yorkville Advisors LLC and its president and chief financial officer charged with scheming to overvalue assets under management and exaggerating returns in order to hide losses and increase fees.[37] The SEC’s complaint, filed in the U.S. District Court for the Southern District of New York alleges that, at least since 2008, the firm and two executives of failed to adhere to the firm’s stated valuation policies, ignored negative information about certain investments, withheld information from the firm’s auditor, and misled investors about the liquidity of the funds and the collateral underlying the investments and falsely claimed that it was utilizing a third-party valuation firm.[38]

Second, on November 28, 2012, the SEC announced its first enforcement action against a public company and its top executives for failure to properly fair value its assets in accordance with FAS 157. The SEC charged KCAP Financial Inc., a publicly traded business development company, and three top executives with overstating the value of KCAP’s asset portfolio.

The SEC alleged that, during the 2008-09 financial crisis, KCAP did not account for certain market-based activity in determining the value of its debt securities and investments in collateralized loan obligation (CLO) funds. According to the SEC, KCAP valued its two largest CLO investments at cost which did not take into account market conditions. KCAP valued the debt securities based solely on an enterprise value methodology and did not calculate (or inform investors of) the FAS 157 ‘‘exit price’’ for the securities. The SEC alleged that the value of these assets were overstated by approximately 27 percent.

The executives agreed to pay penalties of $25,000 and $50,000 and the executives and the company agreed to a cease and desist order in order to settle the charges.

Finally, on December 10, 2012, the SEC announced charges against eight former members of the boards of directors of five mutual finds based in Memphis, Tennessee.[39] According to the SEC, these funds, which were invested in securities backed by subprime mortgages, overstated the value of those securities in 2007 when the housing market was on the brink of financial crisis. The SEC previously charged the funds’ managers and the firms themselves, which paid $200 million to settle charges.

In bringing the action against the members of the boards of directors, the SEC’s Director of the Division of Enforcement, Robert Khuzami, stated that ‘‘[i]nvestors rely on board members of establish an accurate process for valuing their mutual fund invest-

[32] *Id*. at 213.

[33] *Id*. at 206 (quoting *U.S. v. Peoni*, 100 F.2d 401, 402 (2d Cir. 1938)).

[34] U.S. Securities and Exchange Commission, Annual Report on the Dodd-Frank Whistleblower Program, Fiscal Year 2012 (Nov. 2012).

[35] SEC Issues First Whistleblower Program Award, Release No. 2012-162 (Aug. 21, 2012).

[36] *Id*.

[37] SEC Charges Hedge Fund Adviser and Two Executives With Fraud in Continuing Probe of Suspicious Fund Performance, Release No. 2012-209 (Oct. 17, 2002).

[38] *SEC v. Yorkville Advisors, LLC et al.*, Case No. 12 7728 (S.D.N.Y.).

[39] SEC Charges Eight Mutual Fund Directors for Failure to Properly Oversee Asset Valuation, Release No. 2012-259 (Dec. 10 2012).

ments.''[40] Here, however, the SEC alleged that the directors delegated their fair valuation responsibility to a valuation committee without providing any meaningful, substantive guidance and made no meaningful effort to learn how fair values were being determined.

8. SEC Brings Action Against a 'Dark Pool' for Not Being Dark Enough

In late 2011, the SEC brought its first ever action against a ''dark pool'' trading platform.[41] That trend continued in 2012, when the SEC filed an action against eBX, LLC, which operates the ''dark pool'' trading platform Level ATS.[42] Dark pools do not disclose the identity of buyers and sellers and do not display quotations to the public, with the intent of providing their subscribers access to opportunities unavailable to investors using public markets.

The SEC found that eBX, LLC informed its subscribers that their order flow would be kept confidential when, in fact, eBX, LLC allowed an outside technology vendor to use the information about the subscribers' unexecuted orders for its own purposes. The outside vendor therefore was able to use the information about eBX, LLC's subscribers' orders to make routing decisions for its own customers' orders and thereby increase its execution rate. The SEC asserted that the outside vendors' customers received a much higher fill-rate than that of eBX, LLC's subscribers..

When announcing the action, Robert Khuzami, Director of the SEC's Division of Enforcement, noted that ''[d]ark pools are there for a reason: buyers and sellers expect confidentiality of their trading information'' and that eBX, LLC's subscribers did not ''get the benefit of that bargain. . . .''[43]

eBX, LLC agreed to pay a $800,000 penalty and accepted a censure and a cease and desist order to settle the action.

9. SEC Pursues Actions Involving Pre-IPO Trading

In March 2012, the SEC announced that it had brought three actions arising out of its ''year long investigation of the fast-growing business of trading Pre-IPO shares on the secondary market.''[44]

First, the SEC filed a complaint in the U.S. District Court for the Northern District of California against Frank Mazzola and his firms, Felix Investments, LLC and Facie Libre Management Associates LLC, asserting that Mazzola and his firms created, marketed and managed a number of limited liability companies designed to pool investors' funds to invest in pre-IPO companies such as Facebook, Inc. and Twitter, Inc. According to the SEC, the defendants misled investors about the compensation that they earned, engaged in undisclosed self-dealing adverse to the funds, lied about the amount of stock actually held, and misstated material facts about the companies in which the funds were investing in order to attract investors.

Second, the SEC filed a settled administrative action Laurence Albukerk and his firm, EB Financial Group, LLC.[45] The SEC alleged that Albukerk and his firm managed two pooled investment funds created to acquire pre-IPO shares of Facebook, Inc. According to the SEC, Albukerk hid from the funds' investors the full amount of compensation that he and his firm would earn. The SEC alleged that Albukerk represented to the investors that he charged only a five percent fee for the initial investment and a five percent fee when the shares were distributed to fund investors upon a Facebook IPO. In fact, however, Albukerk used an entity owned by his wife to purchase Facebook stock then buying interest in that entity through the funds while charging investors a mark-up. He also earned an undisclosed brokerage fee on the purchase of Facebook shares from the original stock holders. Albukerk and his firm agreed to pay $210,499 in disgorgement and prejudgment interest and a $100,000 penalty to settle the action.

Third, the SEC also filed a settled administrative action against SharePost, Inc. and its founder and president, Greg Brogger.[46] In its Order Instituting Proceeding, the SEC notes that SharePost, an online service to help match buyers and sellers of pre-IPO stock, ''has played a significant role in the emerging marketplace for the stock of companies that have not yet conducted an [IPO]'' The SEC asserts, however, that SharePost and Brogger facilitated securities transactions without registering with the SEC as a broker-dealer. Prior to the action being filed, SharePost took corrective action and acquired a registered broker-dealer. It further agreed to penalty of $80,000 and a censure. SharePost and Brogger also agreed to a cease and desist order.

10. SEC Initiates Enforcement Proceedings Against China-Based Affiliates of Major U.S. Accounting Firms

On May 9, 2012, the SEC commenced an administrative enforcement action against Shanghai-based Deloitte Tomahtsu CPA Ltd. (''D&T Shanghai'') in connection with its alleged refusal to produce audit work papers related to a China-based company under investigation for potential accounting fraud.[47] This administrative action came on the heels of the SEC's attempt to obtain documents from D&T Shanghai through a federal subpoena enforcement action filed in September 2011.[48]

In the subpoena enforcement action, D&T Shanghai asserted, among other things, that producing the re-

[40] *Id.*

[41] *In the Matter of Pipeline Trading Systems LLC*, File No. 3-14600 (Oct. 24, 2011) (Order Instituting Proceedings).

[42] SEC Charges Boston-Based Dark Pool Operator for Failing to Protect Confidential Information, Release No. 2012-204 (Oct. 3, 2012).

[43] *Id.*

[44] SEC Announces Charges From Investigation of Secondary Market Trading of Private Company Shares, Release No. 2012-43 (Mar. 14, 2012).

[45] *In the Matter of Laurence Albukerk et al.*, File No. 3-14801 (Mar. 14, 2012) (Order Instituting Proceedings).

[46] *In the Matter of SharePost, Inc., et al.*, File No. 3-14800 (Mar. 14, 2012) (Order Instituting Proceedings).

[47] SEC Charges Deloitte & Touche in Shanghai With Violating U.S. Securities Laws in Refusal to Produce Documents, Release No. 2012-87 (May 9, 2012).

[48] *SEC v. Deloitte Touche Tomhatsu CPA Ltd.*, Case No. 11-0512 (D.D.C.)

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quested documentation would violate the law of the People's Republic of China and disobey an ''express directive'' of its primary regulator, the China Securities Regulatory Commission (''CSRC'').[49] In July 2012, the action was stayed for six months in order for the SEC, D&T Shanghai, and CSRC and to try to come to an agreement. This effort apparently was unsuccessful because, on December 3, 2012, the SEC moved to lift the stay and for an order requiring compliance with the subpoena.

On that very same day, the SEC instituted administrative proceedings not just against D&T Shanghai, but also BDO China Dahua CPA Co., Ltd., Ernst & Young Hua Ming LLP, KPMG Huazhen (Special General Partnership), and PricewaterhouseCoopers Zhong Tian CPAs Limited.[50] The Order Instituting Proceedings alleges that the Division has ongoing fraud investigations concerning China-based clients of all five firms, that each firm had refused to produce audit workpapers and other materials prepared in connection with audit work or interim reviews in violation of Section 106 of the Sarbanes-Oxley Act of 2002 and seeks sanctions against each firm pursuant to Rule 102(e) of the Commission's Rules of Practice.[51]

[49] *SEC v. Deloitte Touche Tomhatsu CPA Ltd.*, Case No. 11-0512 (D.D.C.) (Respondent DTTC's Statement of Points and Authorities Opposing the SEC's Application for Order to Show Cause and Order Requiring Compliance With Subpoena, at 1).

[50] SEC Charges China Affiliates of Big Four Accounting Firms With Violating U.S. Securities Laws in Refusing to Produce Documents, Release No. 2012-249 (Dec. 3, 2012).

[51] *In the Matter of BDO China Dahua CPA Co., Ltd. et al.*, File No. 3-15116 (Dec. 3, 2012) (Order Instituting Proceedings).