



# SEC Enforcement Data Analyses

▶ Analyses of cases filed by the SEC in calendar year 2014



**Morvillo  
Abramowitz**

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### Focus of this volume

Welcome to the third publication of **Morvillo Abramowitz's** quarterly reports on the work of the Securities & Exchange Commission's Division of Enforcement, beginning with cases filed on or after January 1, 2013. Our firm's first publication contained data and analysis of the Enforcement Division's new cases from January 1, 2013 through September 30, 2013. The second publication analyzed all of the Enforcement Division's new case filings for the entire calendar year 2013. This publication will focus principally on cases filed between January 1, 2014 and March 31, 2014.



## Methodology

Previously, we divided all of the SEC's filed cases into three categories: (1) **"Follow-on"** cases, *i.e.*, administrative proceedings that followed earlier cases (either SEC injunctive actions or parallel criminal cases) citing the result in the earlier cases as a basis for the relief sought in the Follow-on cases, (2) **"Delinquent Filer"** cases *i.e.*, cases in which a public company did not file required periodic filings with the SEC, such as 10-Ks or 10-Qs; and (3) **"Core"** cases, *i.e.*, cases that were neither Follow-on nor Delinquent Filer cases. The reason to divide the SEC's cases into these three categories was to focus on the "Core" cases, since they demonstrated the SEC's enforcement priorities in a way that "Follow-on" and "Delinquent Filer" cases did not.

This quarter, we have added a fourth category: **"Section 8(d) cases,"** *i.e.*, cases in which an issuer was alleged to have made untrue statements or omissions in a registration statement. Ordinarily, such false statements or omissions would be charged as fraud cases (assuming that scienter can be proved). However, on February 3, 2014, the SEC filed twenty separate Section 8(d) administrative cases all arising out of the same set of facts. In the press release announcing those twenty cases, the SEC announced "the filing of stop order proceedings against 20 purported mining companies believed to have included false information in their registration statements. The SEC's Enforcement Division alleges that all of the companies are controlled by John Briner, a promoter who was the subject of a prior SEC enforcement action and was suspended from practicing as an attorney on behalf of any entity regulated by the SEC. However, each registration statement falsely stated that management consisted of a different individual who controlled and solely governed the company. The named individuals varied by company."

If we were to include these twenty administrative cases arising out of the same set of facts in our group of "Core" cases, that would tend to skew the statistical analysis of the SEC's "Core" cases, particularly when viewed in the context of only one quarter of a year. In the first quarter of 2014, the SEC filed a total of 157 cases. By including the 20 cases related to John Briner into the "Core" case category, the statistics will overstate the percentage of all cases that were "Core" cases. Therefore, in order to give a fairer view of the number of "Core" cases filed by the SEC in the first quarter of 2014, we have excluded the 20 cases related to John Briner from the group of "Core" cases filed in that quarter, and put them in their own category of Section 8(d) cases.

# The percentage of "Core" cases declined significantly in the first quarter of 2014 compared to the first quarter of 2013.

With that in mind, the data shows that in the first quarter of 2014, the SEC filed a total of **158** cases, either in federal court or in the SEC's administrative court. **64** of those **158** cases were "Follow-on" cases (or 40.8% to the total filed during that period). During the same period, the SEC filed **26 Delinquent Filer** cases (or 16.6% of the total filed during that period). Also, as noted above, the SEC filed **20** cases on one day alone during the first quarter of 2014 (or 12.7% of the total filed during that quarter). Finally, there were **48 "Core"** cases filed during that period (or 30% of the total).

In 2013, 47.5% of all cases filed by the SEC were "Core" cases. Therefore, the fact that only 30% of the total number of all cases filed in the first quarter of 2014 were "Core" cases (excluding the **20 Section 8(d)** cases) is a significant decline from 2014. (Note: it would be 43.1% if you add the two).

## The Percentage of Core cases in which scienter was/was not alleged remained constant

Of the **318** Core cases filed in 2013, **116** (or 36.5%) did not allege a violation of the securities laws that required a finding of scienter.

Of the **48** "Core" cases filed in the first quarter of 2014, **19** (or 39.6%) did not allege a violation of the securities laws that required a finding of scienter.

From this information, one can infer that with the right fact pattern, in negotiations with the SEC, one can still achieve settlements with no scienter-based claims, notwithstanding language in the complaint that strongly suggests scienter.

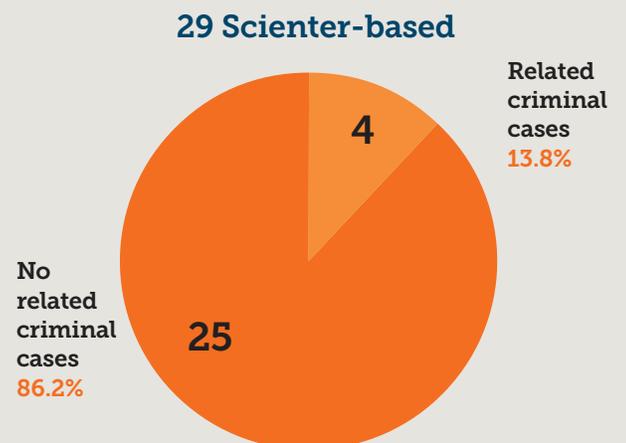
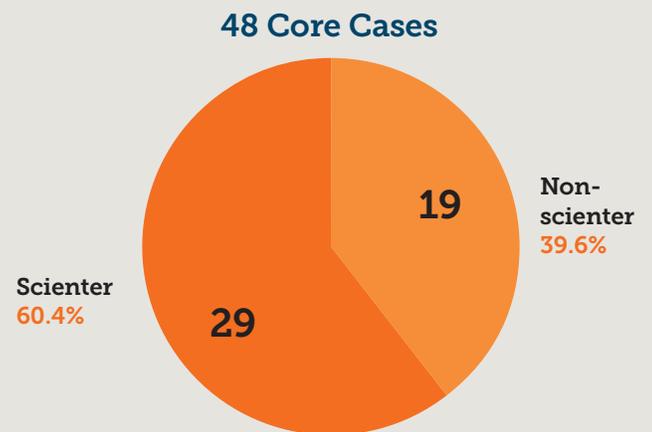
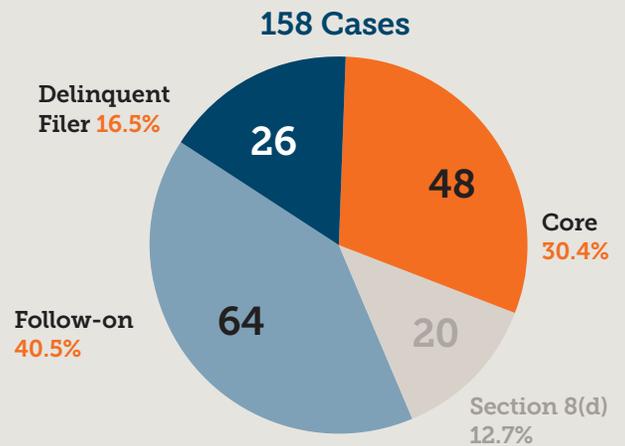
## There was a decline in the overlap between SEC scienter-based cases & related criminal cases

The overlap between SEC scienter-based cases and related criminal cases was not great in 2013, and there was even less overlap in the first quarter of 2014.

Of the **202** scienter-based cases filed by the SEC from January 1, 2013 through December 31, 2013, **48** (or 23.8%) had related criminal charges against the SEC defendant/respondent on or before the filing of the filing date of the SEC complaint.

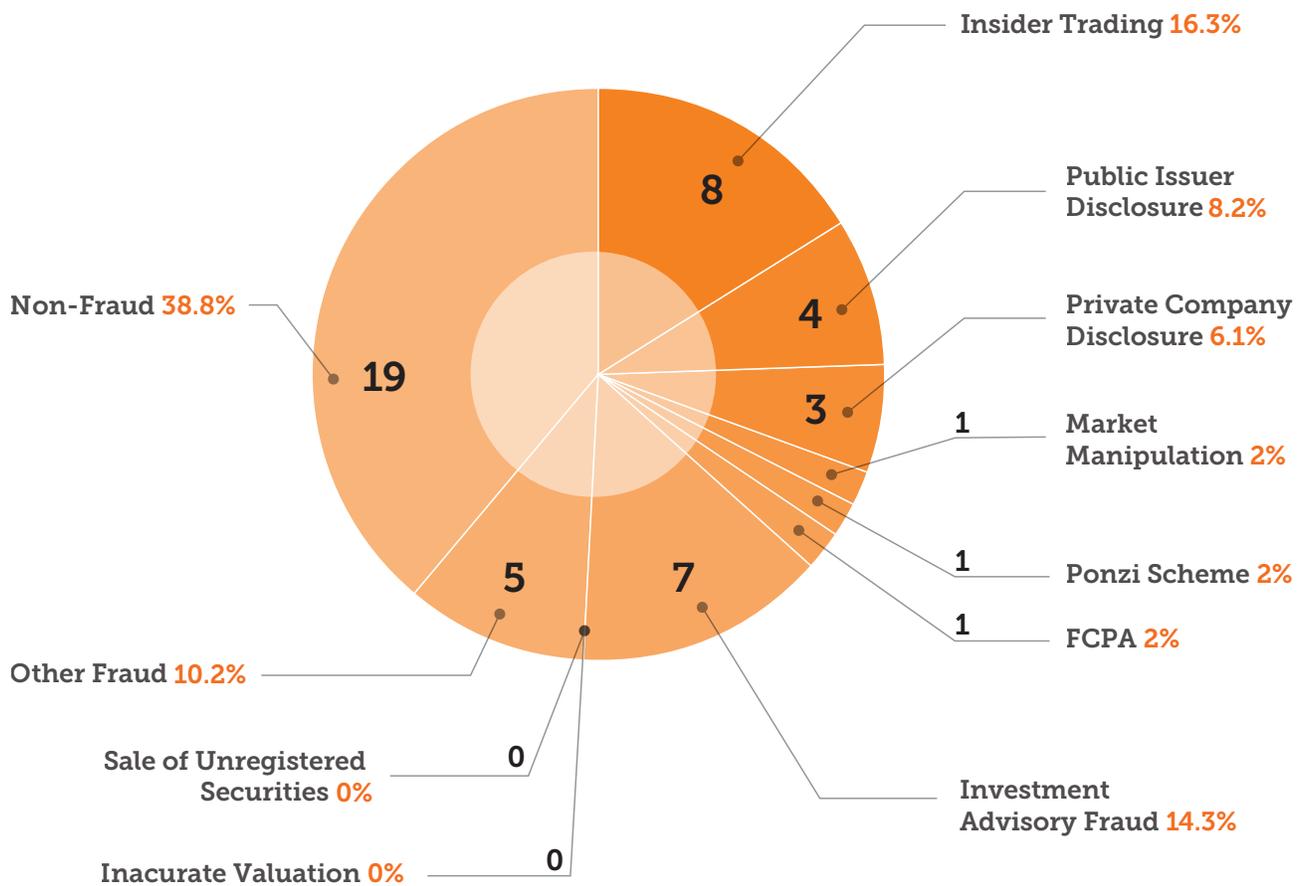
Of the **29** scienter-based cases filed by the SEC from January 1, 2014 through March 31, 2014, **4** (or 13.8%) had related criminal charges against the SEC's defendants/respondents on or before the filing date of the SEC complaint.

As was the case in 2013, we found no apparent correlation between the size of the fraud alleged in the complaint (either by dollar amount or number of victims) and the likelihood of criminal prosecution.



In the quarter ended March 31, 2014, the SEC filed **8** insider trading "Core" cases plus **9** insider trading cases that were Follow-on cases. The following chart shows what types of "Core" cases were filed in the first quarter of 2014, including insider trading cases. When reading this chart, keep in mind that the total number of "Core" cases filed in the first quarter of 2014 was less than one-quarter of the total number of "Core" cases filed in all of 2013.

### Types of "Core" cases filed in the quarter ended March 31, 2014



Note that this table totals 49 cases due to the fact that one "Core" case fell into more than one category, resulting in "double-counting".

## Increasing use of administrative proceedings to litigate fraud allegations.

|                | Administrative Proceedings | % of Month's Core Cases |
|----------------|----------------------------|-------------------------|
| January        | 2                          | 14%                     |
| February       | 3                          | 20%                     |
| March          | 8                          | 35%                     |
| <b>Q1 2013</b> | <b>13</b>                  | <b>25%</b>              |
| April          | 10                         | 40%                     |
| May            | 11                         | 52%                     |
| June           | 3                          | 17%                     |
| <b>Q2 2013</b> | <b>24</b>                  | <b>38%</b>              |
| July           | 9                          | 33%                     |
| August         | 8                          | 24%                     |
| September      | 43                         | 54%                     |
| <b>Q3 2013</b> | <b>60</b>                  | <b>43%</b>              |
| October        | 11                         | 61%                     |
| November       | 12                         | 52%                     |
| December       | 13                         | 57%                     |
| <b>Q4 2013</b> | <b>36</b>                  | <b>56%</b>              |
| January        | 10                         | 67%                     |
| February       | 7                          | 54%                     |
| March          | 11                         | 55%                     |
| <b>Q1 2014</b> | <b>28</b>                  | <b>58%</b>              |

More and more scienter-based cases are being filed as administrative proceedings instead of being filed in the federal court. A total of **185** scienter-based Core cases were brought by the SEC in federal court in 2013; **133** scienter-based Core cases were brought in administrative proceedings during that same period. In each quarter of calendar year 2013, the percentage of scienter-based claims being filed in administrative proceedings increased as a percentage all scienter-based claims brought the SEC.

The trend for the SEC to bring more fraud cases in its administrative court has continued in 2014. The following chart shows (1) how many Core cases were brought in the SEC's administrative court in each month since January 2013, and (2) what percentage of all Core claims were brought in the administrative court.

**Why are there so many non-fraud cases?**

Since we began tracking the cases filed by the SEC since January 1, 2013, we have been struck by the high percentage of "Core" cases that did not require a finding of scienter, *i.e.*, non-fraud cases. 36.3% of all "Core" cases filed in 2013 did not require a finding of scienter. In the first quarter of 2014, 39.6% of all "Core" cases did not require a finding of scienter.

Before addressing the reason for such a high percentage of non-fraud cases, it is useful to look at the various types of cases that fall into the non-fraud category. For example, there were a number of cases filed in 2013

in which municipalities were named as defendants. In one, the SEC alleged that the State of Illinois raised over \$2.2 billion by misleading bond investors. However, the SEC described this as "negligent conduct" and alleged that investors were misled "due largely to institutional failures." In another, the SEC alleged that the City of South Miami Florida made misrepresentations and omissions in a bond offering in which it sought to borrow \$5.5 million. The order instituting cease-and-desist proceedings did not allege scienter, and specifically said that "[v]iolations of Section

17(a)(2) and (3)—which were the applicable statutes in this matter—may be established by showing negligence." However, the SEC's press release in the City of South Miami case referred to "South Miami's fraudulent conduct." Of the eight cases brought against government entities since January 1, 2013, only half alleged fraud.

The SEC also did not allege scienter in a number of cases in which exchanges were charged as defendants/respondents. Included in this group were cases against the NASDAQ Stock Market, the Chicago Board of Options Exchange and the

Chicago Stock Exchange, Inc. In none of the exchange cases were any individuals charged. Similarly, in cases brought against financial service firms (such as Oppenheimer Asset Management, Inc., Capital One Financial Corporation, A.R. Schmeidler & Co., Inc., UBS Securities, LLC, Bank of America, N.A., TD Bank, N.A., Knight Capital Americas LLC, Piper Jaffray & Co. and Merrill Lynch), the SEC did not make any allegations of scienter.

Other types of SEC cases that did not involve scienter included subpoena enforcement cases, negligent accounting, failure to file a registration statement with the SEC (i.e., sale of unregistered securities), failure to supervise, and violations of Regulation M, to name a few.

The fact that these cases—many of which were settled upon filing—did not allege scienter can be explained in a number of ways. First, it may be that the SEC did not have enough evidence to allege scienter. However, it seems unlikely that this explanation applies to all of the non-scienter based cases. Second, it is possible that defendants/respondents negotiated over what charges would be brought as part of a settlement. This kind of compromise is not surprising, nor is it improper or bad policy for the SEC. Each case carries with it choices for the SEC and the potential defendant/respondent, and each party has its own interests to consider. The fact that the SEC could have brought a scienter-based case but did not because it was able to obtain a favorable outcome without litigation is not necessarily a bad thing.

Of course, if the SEC were to routinely settle fraud cases on a non-fraud basis, that would be cause for concern. However, the

reality is that in 2013, of the 320 “Core” cases brought by the SEC, 63.7% alleged scienter. Thus, a comfortable majority of “Core” cases brought by the SEC did allege scienter.

One additional observation about the non-scienter based cases is warranted. In settled cases, sometimes the SEC charges only a violation of Section 17(a) of the Securities Act of 1933. There are three subsections to Section 17(a). Section 17(a)(1) requires a finding of scienter. Sections 17(a)(2) and 17(a)(3) do not. From time to time, the SEC files a case in which the SEC alleges only a violation Section 17(a), without identifying the subsection of Section 17(a) the SEC is alleging was violated. Obviously, this is no accident. For practitioners in this area, the inference to be drawn from this is that it is possible to negotiate a disposition with the SEC in which the SEC will agree to allege only a Section 17(a) violation, without requiring that the SEC’s pleading include a finding of scienter.

### **How often did the SEC bring charges without naming an individual as a party?**

This question was put to us by a reader of this publication. We have examined the data for 2013 and the first 3 months of 2014. The data shows that of the 320 “Core” cases brought in 2013, 253 (or 79.1%) named individuals and 67 (or 21%) did not. The data also shows that of the 48 “Core” cases brought in the first quarter of 2014, 39 (or 81.2%) named individuals and only 9 (or 18.8%) did not. These numbers are somewhat skewed because on one day alone (June 16, 2013), the SEC brought 21 cases alleging violations of Regulation M, and only one of those cases named an individual as a defendant. Excluding the Reg M cases filed

on June 16, 2013, of the remaining 299 “Core” cases brought in 2013, 252 (or 84.3%) named individuals and 47 (or 15.7%) did not. This is bad news for SEC practitioners representing individuals.

### **What is the percentage of cases that are settled at the time of the filing of an SEC pleading, and where are the settled cases being brought?**

This is another interesting question which the data answers. For “Core” cases filed in 2013, 53% percent were at least partially settled upon the filing of the SEC pleading. In the first 3 months of 2014, 59.3% of the 83 named defendants settled the charges against them upon the filing of the SEC pleading.

Critics of the SEC will argue that there are so many settlements at the time of filing because the SEC has given the defendants/respondents too lenient a deal. Proponents of the SEC will argue that the high rate of settlements is a function of defendants/respondents concluding that they have no chance of prevailing against the SEC, and accordingly agree to whatever terms the SEC dictates.

One thing is clear, however, from the data. The SEC is bringing a greater percentage of its settled cases in administrative court rather than in federal court

Of the 318 “Core” cases filed in 2013, 169 (or 53%) were at least partially settled at the time the action was filed. Of those 169 “Core” cases filed in 2013 that were settled upon filing, 60 were filed in federal court and 109 were filed as administrative proceedings. Importantly, the percentage of settled Core cases being filed as administrative proceedings increased through 2013.

## That trend has continued in 2014.

|                   | Core Cases Settled When Filed | % of Month's Core Cases Settled When Filed | Administrative Core Cases Settled When Filed | Federal Core Cases Settled When Filed |
|-------------------|-------------------------------|--|--|---------------------------------------|
| January           | 6                             | 43%  | 1  | 5                                     |
| February          | 7                             | 47%  | 1  | 6                                     |
| March             | 8                             | 35%  | 5  | 3                                     |
| <b>Q1 2013</b>    | <b>21</b>                     | <b>40%</b>                                 | <b>7</b>                                     | <b>14</b>                             |
| April             | 13                            | 52%  | 8  | 5                                     |
| May               | 15                            | 71%  | 11   | 4                                     |
| June              | 6                             | 33%  | 3  | 3                                     |
| <b>Q2 2013</b>    | <b>34</b>                     | <b>53%</b>                                 | <b>22</b>                                    | <b>12</b>                             |
| July              | 15                            | 56%  | 8  | 7                                     |
| August            | 10                            | 30%  | 5  | 5                                     |
| September         | 51                            | 65%  | 38   | 13                                    |
| <b>Q3 2013</b>    | <b>76</b>                     | <b>55%</b>                                 | <b>51</b>                                    | <b>25</b>                             |
| October           | 13                            | 72%  | 10   | 3                                     |
| November          | 9                             | 39%  | 6  | 3                                     |
| December          | 16                            | 70%  | 13   | 3                                     |
| <b>Q4 2013</b>    | <b>38</b>                     | <b>59%</b>                                 | <b>29</b>                                    | <b>9</b>                              |
| <b>Total 2013</b> | <b>169</b>                    | <b>53%</b>                                 | <b>109</b>                                   | <b>60</b>                             |
|                   |                               |  |  |                                       |
| January           | 14                            | 44%  | 11   | 3                                     |
| February          | 17                            | 63%  | 15   | 2                                     |
| March             | 20                            | 59%  | 12   | 8                                     |
| <b>Q1 2014</b>    | <b>51</b>                     | <b>55%</b>                                 | <b>38</b>                                    | <b>13</b>                             |

Note that data for 2014 is broken down by defendant. We did not have that level of granularity in 2013.

It seems clear from this data that the SEC is shying away from bringing many settled cases in federal courts because federal judges are increasing their scrutiny of those settlements, often to the displeasure of the SEC and the parties with whom the SEC wants to settle. This is not to say that all settled cases are being brought in the SEC's administrative court. However, the trend toward bringing more settled cases in the

SEC's administrative court is unmistakable.

The data shows that in the first quarter of calendar year 2013, the SEC settled 21 "Core" cases upon filing, which was 40% of the total "Core" cases filed in that quarter. Of those, 7 (33%) were filed in the SEC's administrative court and 14 were filed in federal court. In the first quarter of this year, 38 of the 51 respondents (74.5%) who settled with the SEC did so in

administrative court, with only 13 (25.5%) doing so in federal court.

Last year, 13 of the total 52 "Core" cases filed in the first quarter (25%), and 135 of the 321 total "Core" cases (41.6%) filed in calendar year 2013 were brought in an administrative proceeding. This year, 28 of the 48 total "Core" cases in the first quarter (58.3%) were brought in an administrative proceeding.

## Final thoughts

As we noted in our previous publication, the two most publicized SEC cases that went to trial in 2013 were the cases against Fabrice Tourre, the former Goldman Sachs executive, which the SEC won on August 16, 2003,<sup>1</sup> and the case against Mark Cuban, the owner of the Dallas Mavericks basketball team, which the SEC lost on October 16, 2013.<sup>2</sup> During the SEC's fiscal year beginning October 1, 2013 through the publication of this report, the SEC's record in trials in federal court has been iffy, at best.<sup>3</sup>

On the eve of the distribution of this publication, the SEC won another highly publicized insider trading case, before a jury, against Sam Wyly and his late brother, Charles, (*SEC v. Wyly, et al*, 10 Civ. 5760 (S.D.N.Y. May 12, 2014): but lost two other significant insider trading cases: *SEC v. Nelson Obus*, (06 Civ. 3150 S.D.N.Y.) (decided by a jury on May 30, 2014) and *SEC v. Mahouchehr Moshayedi* (SA CV 12 1179) (decided by a jury on June 6, 2014).

It is interesting to note that of the cases tried by the SEC since last August, the SEC has lost most of the cases tried outside of the Southern District of New York, and won the most of the cases tried in the Southern District of New York (although the SEC lost the most recent trial in the Southern District of New York in the *Obus* case). Also of note is the much more successful record of the U.S. Attorney's Office for the Southern District of New York in trials of *criminal* insider trading cases over the past few years.

While the number of insider trading trials is still relatively low and not numerous enough to provide data-filled statistical conclusions, one cannot help but wonder whether the SEC and the United States Attorney's relative success in insider trading cases has been helped by the make-up of the jury pools in the Southern District of New York.

It is worth noting that of all of the SEC cases that have gone to trial since October 1, 2013, only one of those cases was originally filed after January 1, 2013. In other words, the cases that have gone to trial in federal court have taken a considerable amount of time to go from the original pleading to trial.

Finally, we note two recent defeats for the SEC, albeit not at the end of a jury trial. The first of these two cases was *SEC v. Barry Graham, et al.* 13-10011-CIV (S.D. Fla. May 12, 2014). According to the Court's opinion, granting the defendants summary judgment, the SEC's complaint, filed in early 2013, "alleged a far-reaching graft perpetrated by defendants upon upwards of 1,400 unsuspecting investors and to the tune of more than \$300 million. According to the SEC, defendants directly, and through a vast web of entities collectively known as Cay Clubs Resorts and Marinas ("Cay Clubs"), offered and sold to these investors what were in fact unregistered securities, but under the guise of real estate investments." However, because the claims were time barred, the Court ruled that it was required to dismiss the SEC's claims with prejudice. In a sharp rebuke to the SEC, the Court wrote: "This is a case in which the SEC—the Agency whose principal mission is to 'protect investors and the markets by investigating potential violations of the federal securities laws—failed to meet its serious duty to timely bring this action." Given that the SEC alleged a fraud of over \$300 million, this was a particularly noteworthy defeat. The SEC has not yet announced whether it will appeal.

The second of the two recent defeats occurred on June 4, 2014, when the SEC dropped its insider trading case against Parker H. Petit, who it had sued in 2012 for tipping inside information to Earl C. Arrowood. *SEC v. Arrowood, et al.*, 12 CV 00082 (N.D. Ga. June 4, 2014). The complaint, filed on January 9, 2012, alleged that "Arrowood obtained \$94,019 in ill-gotten gains" and sought an injunction, disgorgement and civil penalties against both defendants, and an officer and director bar against Petit. Not only was the case against alleged tippor, Petit, dropped, but Arrowood settled for only \$9,899 in disgorgement (a far cry from the \$94,019 sought in the complaint), prejudgment interest, a one-time civil penalty of \$9,899, and an injunction against future violations of the securities laws—with no admission of wrongdoing.

**As always, we are anxious to hear from our readers. Please forward all comments or questions to [lbader@maglaw.com](mailto:lbader@maglaw.com) or [pjanowski@maglaw.com](mailto:pjanowski@maglaw.com).**

<sup>1</sup> *SEC v. Tourre*, Case No. 10-CV-3229 (S.D.N.Y. Aug. 1, 2013) (jury trial) (SEC won).

<sup>2</sup> *SEC v. Cuban*, Case No. 08-CV-02050 (N.D. Tex. Oct. 16, 2013) (jury trial) (insider trading case) (SEC lost).

<sup>3</sup> *SEC v. AIC, Inc., et al.*, Case No. 11-CV-00176 (E.D. Tenn. Oct. 10, 2013) (jury trial) (misrepresentations to investors about the safety of their promissory notes/Ponzi scheme) (SEC won); *SEC v. True North Finance Corp., et al.*, Case No. 10-3995-DWF/JJK (D. Minn. Oct. 22, 2013) (jury trial) (misleading investors about fund's deteriorating financial condition) (SEC won on all claims except one); *SEC v. Kovzan*, Case No. 11-CV-02017 (D. Kan. Dec. 2, 2013) (jury trial) (false and misleading filings case) (SEC lost); *SEC v. Jensen*, Case No. 11-CV-05316 (C.D. Cal. Dec. 10, 2013) (jury trial) (fraudulent accounting case) (SEC lost); *SEC v. Schvacho*, Case No. 12-CV-2557 (N.D. Ga. Jan. 7, 2014) (bench trial) (insider trading case) (SEC lost); *SEC v. Yang*, Case No. 12-CV-02473 (N.D. Ill. Jan. 13, 2014) (jury trial) (SEC lost insider trading claim, won front-running claim); *SEC v. Steffes et al*, Case No. 10-cv-6266 (N.D. Ill. Jan. 27, 2014) (jury trial) (insider trading case) (SEC lost); *SEC v. Life Partners Holdings Inc., et al.*, Case No. 12-cv-00002 (W.D. Tex. Feb. 3, 2014) (jury trial) (misleading investors about aspects of "life settlements" business) (mixed verdict); *SEC v. Radius Capital Corp. et al.*, Case No. 11-Civ. 00116 (M.D. Fla. Feb. 6, 2014) (jury trial) (misleading investors about their investments) (SEC won); *SEC v. Marlon Quan, et al.*, Case No. 11-cv-00723 (Feb. 11, 2014 D. Minn.) (jury trial) (hiding defaults from investors) (mixed verdict); *SEC v. Leslie J. Jacobs, et al.*, Case No. 13-CV-1289 (Mar. 6, 2014 N.D. Ohio) (jury trial) (insider trading case) (SEC won); *SEC v. Sam Wyly*, 10 Civ. 5760 (S.D.N.Y. May 12, 2014) (jury trial) (using a system of offshore trusts to conceal transactions as directors of public companies) (SEC won); *SEC v. Nelson Obus*, 06 Civ. 3150 (S.D.N.Y. May 30, 2014) (jury trial) (insider trading) (SEC lost); *SEC v. Manouchehr Moshayedi*, SA CV 12 1179 (C.D. Cal. June 6, 2014) (insider trading case) (SEC lost).



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This report is the work of Morvillo Abramowitz partner, **Lawrence S. Bader**, and associate, **Peter Janowski**. The opinions expressed herein are those of Mr. Bader and Mr. Janowski, and are not necessarily those of Morvillo Abramowitz.

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