

Securities and Exchange Commission Historical Society
Interview with Anne Flannery
Conducted on April 8, 2009, by Kenneth Durr

KD: Interview with Anne Flannery, Wednesday, April 8th, 2009, by Kenneth Durr. I want to get us to where you became involved in the SEC. You went to Brooklyn Law School. Is that right?

AF: That's right.

KD: Did you study securities law while you were there?

AF: I did. Kevin Duffy was my securities professor, and he was, as he still is, a judge in the Southern District at the time. There were two adjunct securities professors at Brooklyn at the time. The other was this woman who was a partner at a firm called Rogers & Wells. I think at the time I chose Judge Duffy because I thought, "Well, gee, here's a federal judge, he used to be the head of the New York office of the SEC," and of course, Roberta Karmel, who was the other adjunct professor, turned out to be an SEC commissioner. I think she became an SEC commissioner while I was still in Washington.

KD: Did you take courses from both?

AF: No, just from Kevin.

KD: Okay. So it sounds like you had some sense that securities law was the direction you wanted to go in?

AF: Actually not. My real focus when I was in law school was to become a prosecutor. And I worked in a number of clinical programs, both in the Manhattan DA's office, and the New York City Department of Investigation. I spent the last summer in law school and almost all of that last year in law school working in the U.S. Attorney's Office in the Eastern District, so my ambition at that point was to become an Assistant U.S. Attorney as soon as I could. And at that time, as is I think still the case, most U.S. Attorney's offices require some experience. And there was also a hiring freeze when I graduated in 1976, so that across the government there were very few vacancies of any kind. So one of the places I applied to was the SEC, both in New York and in Washington. I received an offer to work in the Division of Investment Management in Washington, which is what I did.

KD: Oh, you went to investment management.

AF: Yes. I started out as a 40 Act lawyer, which was a secret [laughter] for many years. For a number of years, not a lot of people knew that, and then after I'd spent a lot of time doing litigation and enforcement work, you know, the whole 40 Acts area changed through today, obviously, much more activity. At the time, it was much more a regulatory regime where funds would come in for exemptive orders, and it really

predated the substantial reforms that occurred in terms of rule making around the Investment Company Act and things like that.

KD: So you went to investment management because that was the job that was open.

AF: That's right. And it was in 1976, and I needed a job [laughter]. So that was it.

KD: How long did you stay there?

AF: I was in investment management for two years. Ann Jones was the director at the time, and she was succeeded while I was there by Sid Mendelsohn. And one of the matters that I got involved in, I actually tried one of the few administrative proceedings I think ever tried in the 40 Act area. There was a broker-dealer which had facilitated an acquisition by Talley Industries—I forget what the circumstances were, but for some reason, in order to obtain their fee, they had to seek an exemption under Section 17E of the '40 Act, which is a rather obscure provision for these purposes.

The application was denied. They pursued it, and the consequences of that is that there was a hearing before administrative law judge as to whether they should be entitled to receive the fee, and I don't know that anybody had ever done anything like that before, or at least in fifteen years or so, it's a very, very unusual process. And most people either receive the exemptive relief, or if they don't receive the exemptive relief and go away. This was a real exception to that. And so I and another colleague in investment

management tried the case in New York before an administrative law judge at the SEC's offices.

The judge ruled in favor of the applicant and against the staff, and the staff appealed that decision. And so the case was actually briefed and appealed to the full commission. There was oral argument in front of the commission, and my recollection is that the commission agreed with the administrative law judge and granted the relief. But the consequences of that were I got some exposure to some of the people in the general counsel's office who were 40 Act experts. And at that point, Alan Rosenblatt, who had been at the Commission for many years and subsequently went back into private practice, recruited me to come to the general counsel's office or was responsible for Ralph Ferrara, who was then the general counsel, to recruit me to the general counsel's office.

KD: So you went to work for Mr. Ferrara.

AF: I did. And that was probably the best job I ever had at the commission, although some of the others were a lot of fun. What I did was I was in the group that, I think, Richard Humes now heads up. Richard was there at the time, and we represented the SEC and its employees in district court cases where the SEC or its employees were the defendants. So it ranged from tort claims, because somebody had a car accident in a GSA-rented car, to cases where someone under investigation would try and challenge the SEC's authority by alleging there had been unconstitutional breaches in the process.

There was a supreme court case called Bivens, which for some time before this—and now we're talking about, I guess, the late 70s to 1980—it was very popular for any person who was the subject of government investigation to allege that the staff or the government agency that was conducting the investigation had somehow conducted themselves in a way that violated their constitutional rights. And it was intended as a deflection of the government's authority. And there had been some cases over that issue. So for a couple of years, the SEC litigated that issue quite intensely, and, I think, prevailed virtually all the time.

KD: A number of different cases.

AF: It generated a lot of litigation, so that was actually kind of fun. And, I guess, the other thing I did while I was there was worked on appellate cases, a lot of amicus cases that the SEC got involved in. And then the third thing was kind of a hodgepodge of administrative statutes that the SEC was subject to. So a guy named John Sweeny, who was my boss at the time, and I wrote the original confidential treatment rules that people have to comply with to protect themselves from having material they've turned over to the government be subject to the Freedom of Information Act.

I got involved in counseling people whom the commission would designate as the EEO decision maker if employees had a grievance with respect to how they were treated as employees, whether or not they were the subject of any unlawful discrimination. So I wound up counseling the EEO officials on that, and also got involved. Paul Gonson and I

wound up having to help, I guess it was Chairman Shad at the time, draft the Reduction in Force procedures that the commission would have to comply with because, in that particular year, congress failed to pass a budget by the deadline of September 30th.

So, like every other government agency, we were out of money and had to comply with these provisions, so it was a typical clash between whoever the executive was and whoever was in control at the Hill at the time. So all these things had nothing to do with the securities laws I wound up getting involved in. That was kind of a side show.

KD: That's a lot of different stuff.

AF: Yes, it was a lot of different things.

KD: It's curious that that was your most enjoyable time at the Commission.

AF: Well, what was the most fun about it—it was this amazing post-graduate education in securities law, notwithstanding some of the things I just mentioned. So I worked on appellate cases and cases that went to the Supreme Court and sat with Ralph. Ironically, at the time, I thought, “Well, wow, this is what everybody does for a living, you know, has a couple of cases in the Supreme Court during their career,” and I haven't been back, so I'm glad I had the opportunity. But in the Transamerica case, the question was whether or not there was an implied right of action under the Anti-Fraud provisions. The court ultimately concluded that there was a very limited action under the contract

provisions, but not as a general matter under the anti-fraud provisions, but the first time they considered the case, there was a deadlock, they tied, and they set it down for re-argument, which is actually quite unusual.

And so we got to argue the whole thing again, wrote more briefs and everything. It was quite an amazing process to get ready for the Supreme Court and then actually to sit at counsel table with Ralph while he argued the case and have the judges kind of staring down at us. I remember Ralph was not beyond whispering to me during the other party's oral argument, and Justice Marshall was sitting right above us, and it really does look like they are thirty feet above you, and he kind of scowled anyway, and Ralph is whispering to me while the other lawyer is arguing in front of the court, and all I could remember was Marshall staring down at us thinking we were going to get thrown out because Ralph was talking [laughter].

So that was kind of an interesting experience. And there were some other cases that I worked on as well. You know, we filed petitions for cert, or opposed cert and things like that. So it was an opportunity to learn at the very highest levels what were substantively a lot of the significant securities law issues of the time, and to watch all that unfold, to participate in the discussions with the commissioners and things like that as to what the SEC's theory would be, and then to see that developed in the briefing process in front of the courts of appeals and the Supreme Court, and then watch the arguments unfold and then see what happened next. So it was an extraordinary education, and incredibly rich.

In contrast to private practice in particular, one of the great things about working on appellate matters is you have almost a luxurious amount of time to develop the cases and everything else. I mean, we would work on a case for three months and sort of bury ourselves in the library and figure out how we were going to argue it, and then with people like Paul, polish things until they were jewels. And learning how to do that and do it effectively is something that has always stayed with me and, as I said, was one of the most satisfying jobs I had at the commission.

KD: What did you learn from Ralph Ferrara, besides not to talk during Supreme Court?

AF: I would say the most extraordinary thing I learned from Ralph was he has an amazing intellect and enthusiasm, as I said. Ralph was prepared to go where no one else would follow, intellectually and otherwise. And, actually, it led to my leaving the general counsel's office to go to New York. Somewhere along the line, Ralph had learned that the New York office of the SEC was conducting an insider trading investigation where they had every reason to believe these options trades had been made on the basis of inside information because they were so extraordinary. But because they emanated from Switzerland, they couldn't determine what the linkage was. And so Ralph persuaded the commission to bring an action against John Doe, and to seek emergency relief in the form of a TRO to freeze the assets.

KD: What's a TRO?

AF: A temporary restraining order to freeze the assets until such time as, through the discovery process, the SEC could learn who was behind the trades, and whether that person had misappropriated the information from someone, or was themselves an insider. And so the commission agreed, and **Andy Sigmund** and I, who were then working the general counsel's office, went up to the New York office to assist them in preparing the work. They had, obviously, been doing the investigation and drafted a complaint, and so we went in after a few more days and were before Judge Pollack in the Southern District, infamous judge. And he issued a freeze order that froze all of the assets of the Swiss bank in the United States at the time because they argued that they couldn't differentiate among whatever assets they had to pinpoint the, I think, \$2 or 3 million that related to the trades. They also questioned his authority to freeze any assets of a Swiss bank in the United States.

KD: Who questioned his authority?

AF: The bank's lawyers.

KD: Was this Banca della Svizzera?

AF: Svizzera Italiana, that's right. And Judge Pollack being Judge Pollack, [laughter] disagreed with that proposition and told them that until they could figure out which \$2 or 3 million connected to the trades, he would freeze all of the money that they had in the United States. And so at that time, I forget whether it was 100 million or \$300 million,

and it was an unprecedented move by a federal judge, and caught the attention of the Swiss authorities, ultimately contributed to the Swiss entering into a memorandum of understanding for the purpose of exchanging information in insider trading cases, which they had been reluctant to do because, you know, traditionally, the Swiss did only cooperate with investigations involving very specific criminal acts, and they didn't embrace insider trading as one of those.

So the case really was extraordinary, and ultimately, the staff discovered that—there were all kinds of wrinkles in the case. The staff wound up taking discovery in Italy and in Switzerland and in other places. Ultimately amended the complaint to identify someone named Giuseppe Tome, who is a banker in Lugano, Switzerland, who had befriended the wife of Edgar Bronfman, who was then involved in, I think as a potential acquirer or divestiture, I can't remember the issuer for the options that were acquired. But in any event, the case was ultimately tried in front of Judge Pollack many years later. He issued a judgment in favor of the commission. And Tome, who was also indicted by the U.S. Attorney's Office in the Southern District, chose not to come to the United States as he was entitled to do. So it may still be the case that there's a pending indictment against him.

KD: Who were you working with in the New York office?

AF: In the New York office, Bob Blackburn, who I think is still at the SEC in New York, was the lead lawyer at the time involved in the case, and Don Malawski was the regional

administrator, who subsequently became a very good friend of mine, and a client of mine much later in our careers. But Don argued for the restraining order and the asset freeze in front of Judge Pollack and obtained it.

KD: Was your task to come up with grounds for doing that?

AF: Yes. It was my task along with Andy Sigmund, who came up to New York with me. We really were the people who were supposed to write the briefs and figure out the legal basis for the courts moving against someone and freezing assets of third parties without knowing what the causal link was, and there were cases in other areas from which we drew. And subsequent to that, it actually became—I don't want to say a standard practice because it's still uncommon, but it is not atypical for the SEC, even today, to bring an action against John Doe and cause financial institutions that may hold assets that are the fruits of what someone believes to be insider trading. It can be used in other cases as well so that the ill-gotten gains of what might be a violation of the law aren't dissipated before the SEC's able to discover whether there's a link.

KD: So this was precedent setting in some ways.

AF: It was pretty precedent setting at the time.

KD: Did you think you were reaching at all when you were doing this?

AF: I think we viewed it as a major victory when the judge entered the order, and I don't think we expected him to go as far as he did. It really became a critical tool, because at that point in time it was long before the insider trading laws were passed that allowed the SEC to seek anything other than disgorgement—before the penalty provisions and before the whistleblower provisions and all those things. There was very little in the SEC's arsenal.

So getting a District Court to, essentially, employ its equitable powers and the full force of its equitable powers was an amazing shift in the leverage that the commission had, given the limitations at that point in time in terms of international discovery and everything else, and it clearly shifted in favor of the U.S. in terms of the willingness of the Swiss authorities, which is where a lot of people would go if they wanted to mask their trading. And there were a couple of other cases that followed that I got involved in.

A year or so later there was one involving St. Joe Minerals that the commission brought. Actually, my partner, Bob Romano, was the lead lawyer for the SEC in that case, which is how I came to know Bob. And he was at the SEC in the trial division at the time, and I was, by then, in New York. And then in a series of cases after that, the Commission established pretty firmly its ability to do that and to seek all kinds of extraordinary remedies.

My recollection is we relied very heavily on the courts prior use of its equitable powers in cases like the Vesco case where they, essentially, stripped the company of its prior board of directors and put in a new board of directors. It was called International Controls

Corp., I think. But there were certainly cases in the securities area where the courts recognized that in order to fulfill the public interest aspects of the securities laws where the SEC really stood for—let's call it—the Attorney General in favor of defrauded investors, that the court's equitable remedy could be sought, provided you met certain standards of proof.

KD: Now was this a strategy that was developed up front, and the commission was behind, or is this just something that happened?

AF: I think it may have been a little bit more reactive than that. I don't know that, prior to this situation coming up, anybody sat down and deliberately thought, “Let's figure out how to expand the court's willingness to add to our power,” or, “What do we do in these circumstances?” I think, to a certain extent, the outer reaches of how to apply this tool, once the courts were willing to get it, evolved over time. In contrast to, let's say, the development of the misappropriation theory, which I think was a deliberate process where, after the Chiarella case was decided by the Supreme Court the commission set out to try and figure out what the alternatives were.

And, in fact, by that point in time, I was in the New York office of the SEC and actually oversaw the Materia case, Anthony Materia, which sort of became the seminal case that confirmed the validity of the misappropriation theory.

KD: I want to get to that. You appeared to spend a lot of time in insider trading over the next few years.

AF: Yes.

KD: Did you make the jump to the New York regional office right after your involvement?

AF: Pretty close. What happened was I am from New York and had always wanted to return, and got to know the people in New York, including Don Malawski. And so as the Tome case was progressing, Don recruited me to come to New York to be the chief trial counsel in New York, which at the time would've been to sort of oversee their litigation. The New York office and the regional offices generally have always had a relatively high litigation docket, and have always worked very closely with the U.S. Attorney's Office in the Southern District, so there were always a lot of cases going to trial. It was just a part of the tradition in this office. And so since I had a lot of appellate and district court litigation as a result of the time I had been in the general counsel's office, he encouraged me to come to New York and take that position, which I did.

Probably after I was in the office for about a month, the home office—John Fedders was then the director—was getting ready to file the St. Joe Minerals case, and they borrowed me to help them draft the papers. And then we did it again because by that time, the Swiss had had an adverse reaction to Judge Pollack's assessment of international law and his authority. So there were some issues that the Commission had to tread a little bit

more carefully in pursuing St. Joe Minerals. Actually, in that case, they wound up employing to a much greater degree the letters rogatory process and, you know, the more difficult but well-respected use of various international agreements.

The other person who worked with Bob Romano on that case—I really wasn't involved much after the original filing—a young staff lawyer by the name of Michael Mann worked on that case. Michael, ultimately, became the director of the Commission's first office of international assistance. And it was really through that case and learning about both the tools that were available under international discovery rules because of the treaties and things like that and the Hague Convention, as well as understanding what the limitations were, the Commission embarked on a series of memorandums of understanding around the world, which has led ultimately to the kind of international assistance that you see now, which is practically triggered by picking up the phone, whereas in the past, there was this very time-consuming process.

KD: So you could say the first lever was you getting to the Swiss bank through Judge Pollack.

AF: Right. And then I think the second prong of that—and this was probably more deliberate than reactive—was “Okay, let's do it regular way now and let's exploit whatever tools are available.” And to the extent there aren't any, we have the leverage of going back to a Judge Pollack and getting him to fill out the holes that we see in this treaty process. And that gave the commission, I think in conjunction with the State Department, the leverage they needed to negotiate memoranda of understanding that were obviously much easier to

use and more in line with the niceties of diplomatic relations than running into a district court judge every time we needed some intelligence that we couldn't otherwise get.

KD: Fedders actually went abroad, and I think Michael Mann went with him.

AF: Yes.

KD: You didn't get to do that.

AF: No. That's Michael Mann's story, not mine.

KD: I want to get a sense of the New York regional office in the early 80s in this period in which you came in. Don Malawski's running the office. I guess there's a couple hundred people or something like that. Is that about right?

AF: Yes.

KD: And I'm assuming that the majority of your trial work didn't really involve insider trading. Is that the case?

AF: It was really a whole panoply of things, although insider trading remained a critical part of it because one of the last cases I worked on involved what came to be known as the Yuppie Five when Ike Sorkin was the regional administrator. But, you know, the Materia

case was probably one of the most significant insider trading cases that we worked on. Before that, the office had brought a case that I wasn't really involved in involving two brothers who are lawyers. Their last name is Rubenstein. And that was another step in the direction of, you know, these people were not traditional insiders in the sense of being officers and directors of the company, or they were people who may have come to know the material non-public information because they were aligned with the acquirer, as opposed to the company. And so it was really—in the Materia case, obviously, he was a printer. It was the same facts as Chiarella.

KD: Were you involved in Chiarella?

AF: I was not. I was at the commission at the time, but I was not involved in that. So when the office in New York began to develop the Materia case, and virtually the same facts. Printer working on deals using a discount broker to place trades. We spent a lot of time collaborating with the general counsel's office to make sure that when we plead the case—and the trial strategy of the case—that we were going to be able to establish the record that we thought we needed to validate the theory that the court suggested in the Chiarella case was something that might stand scrutiny.

The problem with Chiarella was it wasn't plead all the way up and the jury didn't receive instruction on it. So there were intimations in the decision that that would work as an alternative theory, but it didn't work in the Chiarella case because of the way it went up.

KD: Going into Chiarella, the SEC's still got the fiduciary duty argument. Is that right?

AF: I think that's right, and it's a long time since I read the case, but I think the problem that remained unsolved after Chiarella was making sure that you could tie what I would call the theft of information by someone who had a duty—that you could really expand the concept of to whom the duty was owed. And if you owed a duty to party A; i.e. the printing company, who in turn owed a duty of care to its client, which I think was the acquirer, that somehow a breach of that duty could be tied to the purchaser sale of the security in the acquiring company, to whom you owed no duty. I mean, that was the disconnect that, I think, had existed prior to that.

So if you had a breach on the one hand, even if it wasn't to the target company in whose securities you were investing, but you then went out in breach of the duty to party A, bought or sold securities in party B, it was the juxtaposition of those two things that would support the proposition that you had committed a fraud in connection with the purchase or sale of a security. And, ultimately, that got tested and, I think, sustained in the O'Hagan case in the Supreme Court several years later. In *Materia*, the Second Circuit affirmed what turned out to be judgment in favor of the commission in the *Materia* case. And then I think cert was denied in the *Materia* case. It was a number of years later, until O'Hagan when the Supreme Court actually had squarely in front of it the misappropriation theory. And, obviously, there were a bunch of other cases between *Materia* and O'Hagan.

KD: So if we look at Materia, can we see misappropriation in there?

AF: Oh, yes. Absolutely. That was the driver of the case. A young lawyer on the staff named **Mark Jakowski** tried the case for the Commission. And we tried Materia not only for his own trades, but for trades his ex-wife placed on the theory that he owed her money as part of their separation agreement, and the way he kind of tried to meet that obligation was to give her tips, and we said that was an extension of the breach. She was a tipee. And rather than sue her, we sued him as the tipper for her. So there was a friend of his who placed some trades as well, and so we charged him as a tipper of the friend. Judge Bryant was the judge in the case. Midway through the trial, we were still trying to figure out how to prove certain things.

Materia and his friend both placed their orders with discount brokers. And discount brokers in those days—and still today—tape their calls. This is long before email. And we had actually hired an expert to try and clean up the tapes, having the tapes which contained the orders by Materia's friend, so that we could try and establish from a time perspective that he could only have placed those trades after having spoken to Materia, and we had some telephone records and things like that.

Well, it turns out the forensic expert that we hired was able to clean up the tapes, and he called us up and he said, "I think I can hear Materia's voice on the tape." Materia had a very distinctive voice, very distinctive voice. Very strong New York accent. And he had spoken from time to time in the courtroom. And so because of the way in which we

learned about them, we didn't have to produce them in advance of the trial—we learned about them during the trial. So they were information we could use for impeachment purposes. And Materia took the stand, and Mark began to cross-examine him. He denied everything, in this incredibly distinctive New York accent, and was a kind of belligerent fellow. That was his kind of personality.

I was sitting at the table for the SEC, and behind me were the lawyers for Mr. Materia. And Mark began to ask more and more specific questions. You know, “Isn't it a fact that you told the other person,” who was the tpee, you know, “to buy such-and-such on such-and-such a date?” And, “Didn't you tell him when the merger was going to take place?” And, “Didn't you say this? Didn't you say that?” And he denied it adamantly.

Suddenly, I think they came to realize that Mark was using very specific quotes. “Isn't it a fact that you said this to John? Isn't it a fact he asked you when the merger would take place?” And, “Isn't it a fact you said to him, it's going to happen on X date?” And behind me, I hear one lawyer whisper to the other, “expletive deleted, they have tapes.” And, of course, we did, and we succeeded in getting the tapes in, and Mark confronted Materia with these tape recordings.

They used a pay phone in the street, and you can hear his friend place the orders over the phone, and whoever's taking the order, their question is how soon it has to be executed, and he turns to Materia and he says, “When is the deal going to be announced?” And you hear Materia, very, very distinctively say, “It's going to happen whenever.” And Materia,

when confronted with that, refused to acknowledge that it was his voice. And the judge, having heard him now for two days or so, direct examination and cross examination, took judicial notice that he, himself, the judge, had become familiar enough with his voice that he was able to recognize it on the tape.

And so apart from sort of establishing the legal principle, it was one of those great moments when you've just got the other side, and they were totally surprised. There was even an article in the *Wall Street Journal* at the time kind of warning people that now, in addition to everything else, the SEC was able to check tapes and things like that. And, obviously, the broker had retained them and made them available to us. Long before e-mails, the SEC became expert at thinking about other sources of information. So that was a lot of fun.

KD: Why was it denied cert?

AF: Well, who knows why the Court at that point in time—we prevailed at the trial level, the Second Circuit affirmed, and felt that there wasn't really any evidentiary basis on which there could be an appeal. It was a pretty slam-dunk case on the evidence. And the Second Circuit, I think, found that it was consistent with some other cases that were close enough. I mean, they hadn't ruled on the misappropriation theory before. I may be mistaken but I think the Second Circuit had been the court involved in the Chiarella case, although I could be wrong about that. So from the Second Circuit's perspective, you know, this was good.

And at the time, I don't know that any of the other circuit courts had yet had occasion to consider the misappropriation theory, so from the Supreme Court's perspective, there was no controversy, no conflict among the circuits. So in that atmosphere, a cert denied, for the most part, validates a theory. And until—I forget which circuits ultimately disagreed—but until the O'Hagan case went all the way up, it was exceptional for a court not to look to the *Materia* case, the Second Circuit's opinion in the *Materia* case. And the fact that the Court had denied cert, you know, it would take a courageous court of appeals to overturn that.

KD: Were you involved in the *Dirks* case also?

AF: I was not involved in the case named *Dirks*, but one of the first cases I tried when I got to the New York office was against Ray *Dirks* and some others. After the SEC lost the *Dirks* case, he became the head of an investment banking firm in New York called John Muir. Muir brought a lot of small companies public in the late 70s and early 80s and one of them was a company called the Cayman Reinsurance Company. It was actually in Oklahoma. The principals were in Oklahoma, but the insurance company, obviously, was formed in the Cayman Islands.

And we filed a complaint and alleged that the underwriters, John Muir and Ray *Dirks* individually, had not done adequate due diligence. And there were material misstatements in the offering documents with regard to some issues surrounding the

company. I don't remember what they were, other than the allegation by the commission was that a quid pro quo for bringing these companies public was that they would take a certain amount of the proceeds of the offering that was raised by Muir and invest in other Muir underwritten offerings. And we tried that. We filed a complaint, and the case went to trial in front of Judge Connor, and I tried the case, as I said.

And at the end of the day, the judge ruled that he, in fact, had violated the anti-fraud provisions, but declined to issue an injunction and felt, for a whole variety of circumstances, that the Commission hadn't met its burden in terms of why the extraordinary remedy of an injunction was necessary and, in fact, seemed to be colored, in part, by the fact that the Commission had gone all the way to the Supreme Court in the prior case involving Dirks and had not prevailed, and questioned whether some of the staff's or the Commission's enthusiasm for a case against Mr. Dirks wasn't colored by that. So at the end of the day, the court decided not to enjoin him, but did find that he had violated the statute. We appealed that to the Second Circuit, and the Second Circuit affirmed the case and left it as it was. Violation, yes. Injunction, no.

And again, at that point in time, the commission was not able to seek money, fines or penalties, and disgorgement was very difficult to sort out in connection with that case. So cases like that, I think, and other circumstances, ultimately led the Commission and the Congress to add to the arsenal, if you will, of penalties that could be obtained.

KD: And the '84 Act, I guess.

AF: Yes.

KD: Another case that came across my radar scope was First Jersey Securities. Were you involved in that one?

AF: I was. That was an interesting saga. I got involved many years before I got to the New York office. The New York office initiated an administrative proceeding against First Jersey and Mr. Brennan individually for problems in connection with various offerings that they did. And as I understood it, the case had bogged down, had been suspended in connection with settlement negotiations. The settlement negotiations failed, and the case was never reinstated. And when I got there, was right around the time that the Commission and the staff decided to reinstitute the then-pending but somewhat dormant proceeding.

And at the same time we were getting ready, there was a new investigation of a particular offering they had done that involved a relatively narrow violation. I'm not even sure it's on the books anymore, Rule 10b-6, in connection with a certain kind of offering. And whether or not First Jersey and its representatives received what was known as special compensation in connection with this offering, the implication being if you're recommending that people buy A versus B, and in conjunction with A, you get more compensation than if they took B, then maybe there's an obligation to disclose that. A

variation on that certainly in the potential conflicts certainly is front and center in a lot of the cases that the commission has brought.

The cases in the last couple of years where funds, for example, paid to be part of the more narrow group of offerings which would get more prominence. But I guess this was an early version of that. In any event, when the staff chose to initiate the proceeding, then this issue arose as to whether or not the staff had stored all of First Jersey's files that it had collected for its defense in that proceeding. First Jersey sued the SEC to enjoin it from going forward with the administrative proceeding on the theory that the staff had taken for safekeeping all of First Jersey's defense files and, subsequently, lost them because, to state the obvious, the staff didn't have any of these files.

There were apparently several file cabinets and other stuff because when the proceeding was going on, they moved in all their evidence rather than take it home every night, and it was in file cabinets. And then, supposedly, when the case was suspended originally, people didn't know how long it was going to be. So, supposedly, the file cabinets were moved someplace on the premises of the federal building. And then weeks turned into months, turned into a year or two and, supposedly, nobody ever inquired about the files.

So anyway, we found ourselves on the wrong end of a restraining order that First Jersey obtained from a lower court judge in the state court system in New Jersey. I can't even remember where it was, but it was not a federal court, it was a state court, and they obtained this injunction restraining the staff from going forward with this administrative

proceeding because we had breached the constitutional rights of First Jersey, etcetera, by losing all their files, and so they weren't in a position to defend themselves. That was, essentially, the theory of the case, and sort of harking back to the things that the staff had been confronted with when I was in the general counsel's office, that was kind of the modus operandi of the defendant. You know, deflect the Commission and try and argue this.

So Harry Weiss, who was in the general counsel's office at the time, and he's a partner at Wilmer—he and Richard Humes, who was still at the SEC—defended the SEC in that case, and the order of this lower court judge was appealed by the Commission to the court of appeals in New Jersey, who ultimately set it aside: said some interesting things at oral argument. And a few months later, the judge who had entered the original order, without notice to the Commission, I might add, was impeached for judicial misconduct in connection with buying for himself properties and things that came to his attention in connection with some of the cases he sat on. It was sort of an amazing coincidence.

So once Harry got the injunctive order set aside, there were all kinds of other machinations to try and prevent the administrative proceeding from going forward. And so by then, this narrow 10b-6 case was ready. It involved a company called Geo Search, I think, Geo something. We filed the case in front of Judge Sprizzo and didn't seek any emergency relief, just tried to file the complaint, and we're going to proceed through discovery and things like that. And First Jersey reiterated this claim as an affirmative defense that, you know, we had lost the files and so on and so forth.

So the judge, who had been, along with Peter Flemming, the lawyers—in connection with an earlier episode in the Commission's life there was a case against Gulf & Western that the Commission had brought in the early 70s in D.C. And Sprizzo and Flemming, then defense lawyers for Gulf & Western, almost succeeded in getting the complaint set aside because they alleged that the SEC staff at the time had developed its evidence by causing the lawyers for Gulf & Western to breach their attorney-client privilege. And so Sprizzo was very skeptical, as you might expect, and sort of receptive to the proposition that the staff might do things, like lose files that it shouldn't.

And so they wound up drawing the right judge. Anyway, he allowed discovery to determine what happened to the files. Each party took discovery, all kinds of people were deposed. Many people in the staff of the SEC were deposed by First Jersey. We deposed everybody on First Jersey's staff. We sent subpoenas to the warehouse. There were issues never completely resolved as to whether or not, in fact, the files had been moved at the behest of First Jersey. That was our operative theory, and one we asserted in court with the evidence we were able to gather.

We actually had an evidentiary hearing before the judge and witnesses. And before he could decide—while the matter was still pending in front of him—his clerk called us one day and said, “The judge wants to see you all in like twenty minutes, and he's very upset.” So assuming we were going to be on the receiving end of that, because Judge

Sprizzo is a very brilliant judge, but very mercurial, very bad tempered at times, very impatient.

So we get over to the courthouse, and he insisted that Mr. Brennan be there as well, and he starts talking. We're all sitting there. And it turns out that he had found out that Mr. Brennan, who owned horse stables called International Thoroughbred Breeders, had named a horse after him called *Sprizzo's Honor*. It was kind of a play on the movie that Anjelica Huston was in with Jack Nicholson called *Prizzi's Honor*. And he was so angry that he concluded he could not be fair in this proceeding, and he was recusing himself, he was taking himself off the case, and we would hear from whoever the case was going to go to. And so we all left. Brennan had also named a horse after the SEC. It was called *Viva SEC* because he felt he had been very successful in staving off the commission.

So anyway, weeks go by and we get a call, and the case has been reassigned to Judge Pollack, my old friend from the Tome case. To make a long story short, after a few sessions in the judge's chambers, Mr. Brennan consented to an injunction, and that was the end of that case and we never had to worry about the files again. It took many more years, and people other than me who ultimately brought a much bigger case against First Jersey got an injunction. He declared bankruptcy to avoid paying the disgorgement orders. It turned out he committed fraud in connection with the bankruptcy, and that was ultimately what led to his imprisonment, and I think that's where he is today. So that was my brush with First Jersey.

KD: He could only stave off the SEC for so long.

AF: Yes.

KD: Well, let's get into those later insider trading cases. Now at some point here, Ira Sorkin comes in and takes over the New York province, right?

AF: Yes. Ike came and ran the New York office, and we actually had a case involving a promoter named Richard Hirschfeld who was raising money for a company that was going to own a boxing camp for young boxers, and the chairman of the board was Muhammad Ali. We didn't sue Mr. Ali, but we did sue Mr. Hirschfeld, and he called Muhammad Ali as a witness. What he failed to disclose to investors was that all the money for the proceeds was going to be used to buy this property, and in fact, he already owned the property and he was selling the property to the company at a very inflated price. And there were other problems.

We prevailed in that case, but what was interesting about that case was that he called Muhammad Ali to be a witness on his behalf, and at that time, no one knew that Muhammad Ali had Parkinson's and had deteriorated physically. And, you know, the whole boxing bar and the New York press was there because Hirschfeld thought it would be a good thing for his side for them all to see it.

And it so happened at the time that we had an all-woman trial team that tried the case. And one of the very senior lawyers in the office, Peg McQueeney, was eight months pregnant at the time. And she got up to cross examine Muhammad Ali, and she asked him very gently whether or not he'd ever read the prospectus, and he admitted that he couldn't read. And I thought the judge was going to come across the podium and strangle Hirschfeld at that point because it was so obvious that he had exploited this guy. And, in fact, when he ruled from the bench not too much longer after that, he not only concluded that Hirschfeld had violated the securities laws, should be enjoined, the offering should be stopped, all the money should go back to the investors, he spent some time excoriating him for exploiting this icon who, it was also obvious, was ill. It was really the beginning stages of his illness. It counted against Mr. Hirschfeld.

Within a year, Mr. Hirschfeld was raising funds for another enterprise in Germany, and we found out about it and brought a contempt case against him, and the judge held him in criminal contempt for violating the terms of his injunction by trying to raise money. Some people never get over it.

So we did things other than insider trading. The insider trading, there were a couple, but the Yuppie Five case, as it came to be known, involved a group of young professionals, lawyers and young aspiring investment bankers. I can't even remember which bank they stole the money from, but we brought a case against them. Again, the U.S. Attorney's Office got involved and, ultimately, I think there were some criminal prosecutions as well.

You know, there wasn't really anything novel about the case other than how depressing it was that these young professionals, who had blue chip educations and who were really just all starting out, were absolutely amoral [laughter] in terms of their approach. I can't remember what the circumstances were, but one of the first people we confronted and we brought over to the U.S. Attorney's Office flipped. And so he was wired and had conversations with the others, including conversations by the guy who was the lawyer in the group counseling people how to lie during their testimony and obstruct the investigation and so on and so forth.

Probably the thing that was most striking about the case was that at such a young age, here are these guys who talked about emulating their heroes: you know, the case against Boesky had happened, the case against Dennis Levine had happened by then. And notwithstanding the fact that those guys had their own problems, these people were their wannabes. They were just starting out, and their ambition was to be either Gordon Gekko or Ivan Boesky. And at a very young age, notwithstanding all the opportunities they had, were prepared to throw that all away for this.

KD: And ultimately did.

AF: Yes.

KD: Well, there was a lot of that going around. One of my questions is how much did the New York office help in the Levine and Boesky cases and some of those other high-profile insider trading?

AF: Very little. I would say we were really on the periphery of those cases. They were all developed in the home office. And, you know, because they were brought in the Southern District, we would function as local counsel, but it was really no more than that. So we kind of watched it all unfold and sort of basked in the success. There was a wonderful argument in front of, I've forgotten which judge it was, but John Sturc was the lead lawyer for the SEC, and Arthur Liman was Dennis Levine's lawyer. It was over whether or not the temporary restraining order should be converted to a preliminary injunction. And the courtroom was packed, literally.

And Liman, who I think had not been well briefed, frankly, by his colleagues, was arguing the significance of some case and insisted that it held for this proposition rather than that proposition and went on and on and on about it. The judge was fairly patient and quiet, and John kept sort of attacking back. The proof appeared to be pretty compelling in terms of why there was sufficient evidence to continue the injunction. Of course, it was all about the asset freeze because all of Levine's money was tied up.

After being really nice and arguing on the merits for a really long time and arguing with Liman about the significance of this particular case, John finally, in some frustration, said, "I know that's what the case holds because I was one of the parties in the case, and

it's a decision that Your Honor rendered.” And it became apparent that Liman didn't realize that the case he was arguing was a case that this particular judge had decided. And so the judge probably knew it at least as well, if not better, than the parties. And that misstep—in conjunction with, John was just amazing that day.

He came out, and while he had started by saying, “I'm not at all convinced that I should enter a preliminary injunction,” he got off the bench, he came back and he imposed the preliminary injunction. And, of course, it was that, it was the asset freeze that caused Levine to decide he should cooperate. He gave up Boesky, etcetera, etcetera.

KD: So you were there?

AF: I was in the audience [laughter]. I was in the audience with everybody else. That day belonged to John Sturc. It was fabulous, and it was very empowering. You know, the Commission was very aggressive about using the tools that it had. While I was there, one of the other things that we did, although it was something that had been done in the 70s when Ike was there, was we very aggressively brought contempt proceedings where we thought we could if we found people. The reality was, back then, even in the early 80s, the only tools that the commission had were injunctions or securities bars in administrative proceeding. And you could get a district court judge to order disgorgement, but it was often difficult to find the proceeds, and that wasn't that easy. So there were no treble penalties, there were on fines, there were no other things other than getting the U.S. Attorney's Office to bring a criminal proceeding as well.

So we needed to be as aggressive as we could. And one of the things we could do if we got an injunction against somebody, or if somebody had been barred from the securities laws, but chose, nevertheless, to stay in the business in some fashion, was to go to court and seek remedies, either civil contempt or criminal contempt, and so we did that quite often. And I guess the Commission is still doing that. I see them bringing cases from time to time. Now if they prevail in the first wave, they're much more likely to obtain disgorgement or fines or other things that either act as a natural deterrent, or at least disable that particular person from resurfacing any time soon.

KD: We're almost at an hour, and I don't want to let you go without talking a little bit about the Marcus Schloss case, which came out of the Yuppie Five case. Was there even a Marcus Schloss cases when you were still there, or was it in the works?

AF: There was. That case came to us. I have to think about this for a second. I'm going to be slightly circumspect because I can't recall how much of this came out in the public domain, but the case came to us from an insider. And that led to our investigation. I don't think the case was filed before I left the office. I can't recall. I think Jeff Zuckerman, he was certainly overseeing the investigation when I was there, and then was the lead trial lawyer when the case proceeded. The case had a lot of tentacles and I just can't remember as I sit here how far it had gotten by the time I left.

KD: And the big issue, of course, was that it apparently got stalled in the New York office.

AF: It did take some time to proceed.

KD: So the circumstances regarding your leaving the New York office, were the newspapers pretty much right about that? Was it a matter of fatigue or something like that?

AF: I was not fatigued when I left, but I was frustrated. My departure prompted some level of scrutiny, some changes, and that case got back on track. **Bill Goose** came up to run enforcement for several months, and Jim Clarkson, who's currently running the New York office temporarily [laughter], came up again to run the New York office. I went off to the desert and I joined Morgan Lewis. So you see life as a circle, the two people who were at Morgan Lewis at the time who recruited me were Bob Romano, who I had worked with on the Santa Fe case, Bob was on the Santa Fe case. St. Joe Minerals was the Giuseppe Tome case. And Mr. Tome's lawyer in the United States was a lawyer by the name of John Peluso. And John Peluso and Bob were then partners here at Morgan Lewis.

They had come to start a practice, and the two of them persuaded me to come join them. So, indirectly, Mr. Tome and whoever—the director, turned out it was an insider. It was Darius Keaton who was a director of the Santa Fe Minerals Company, or its acquiring company, and he had used a fictitious Arab Saudi name, and had done the trades through a Saudi bank, and Bob and Michael Mann ultimately found that out. So Mr. Keaton and Mr. Tome were responsible for my coming to Morgan Lewis.

KD: Well, is there anything else we should touch on before we wrap up?

AF: I don't think so. The only thing I would say is, you know, it always sounds better in the retailing, but my career at the SEC was very satisfying and a great deal of fun with all kinds of whacky things, as well as a lot of successes. I think what I have in common with so many other alumni is that, while the stories may be different, so many people have had a similar experience in the sense of that much success and responsibility and sort of fascinating experiences. It's one of the things that binds SEC alum together, I think, is that whatever – you invariably hear people say, “It was the golden age when I was there,” and I have heard that.

When I was a young lawyer at the SEC, it used to make me crazy because the investigators, in particular, in New York would always talk about how during the office's heyday, which was, obviously, their primetime, it was wonderful. And what you realize in retrospect is if everyone can walk away over a span of 75 years saying that, then that's a pretty good story, and I think most people would say that.

KD: It's always the golden years.

AF: Yes. As it should be.

KD: Terrific. Thanks very much.

AF: Okay. You're welcome.

[End of Interview]