

Securities and Exchange Commission Historical Society
Interview with Fiona Philip
Conducted on June 19, 2015 by William Thomas

WT: This is an interview with Fiona Philip for the SEC Historical Society's virtual museum and archive of the history of financial regulation. I'm Will Thomas. The date is June 19, 2015, and we're in Washington, D.C., at Sidley Austin. Thanks very much for agreeing to speak with us. We usually start with personal background so we know where you're coming from. Could you tell me a little bit about yourself?

FP: I'm a graduate of Georgetown University, both undergraduate and Law Center, been in this area since that time. I took my first securities regulation class the last semester of law school and decided that this was going to be my career path.

WT: How did you get into law in the first place?

FP: Law school was something that I always wanted to pursue. I was on a different trajectory in terms of what I thought I wanted to do, which involved arts and the law, and I took Professor Donald Langevoort's class. It was the first time he was teaching at Georgetown. I think he had come on a secondment from Tulane.

WT: Now, you were there for both your undergraduate and for law school?

FP: That's right. Professor Langevoort's class changed the path of my law career.

WT: And then you came directly to the SEC out of law school, is that correct?

FP: That's right. I was part of the SEC's honors program, which is a program that I understand they no longer have. I don't know what year they ceased operating the honors program, but yes, straight from law school to the SEC.

WT: Tell me a little bit about the honors program. I haven't had anybody else mention that.

FP: From around the country, the SEC would select ten to fifteen law school graduates who they thought were deserving of a position, not necessarily in enforcement, but at the Commission, and I applied. I remember I was taking securities regulation at the time, and having spoken to Professor Langevoort about how to pursue a career in securities regulation; his great idea was to go work at the SEC. And so I pursued it.

In the months leading up to my graduation, there was an SEC job fair, which I attended. Jim Clarkson, who everyone has fond memories of—I met him at the job fair and applied to the honors program following the job fair. I received offers from the New York office and the Washington office, and had to make a determination of which office I wanted to be in. I pursued enforcement because I was interested in investigations and litigation, and so I chose the Washington office. It was home, and I think, also, the New York office was moving a little slower than the Washington office.

WT: With an honors program, did you spend time at the SEC before you actually started in there as full-time staff, or was it a track to get in there?

FP: No, not at all. You apply like anybody else would apply, whether they were from a law firm or anyplace else. There were just a number of slots that were reserved.

WT: So basically, a recruiting mechanism.

FP: Exactly.

WT: I see. What was your position when you got to the SEC?

FP: I started in the Division of Enforcement in Washington in 1999 as a staff attorney. I started I think the same week as Steve Cutler came aboard as the Deputy Director of Enforcement. I was assigned to a branch, like everyone else would be, coming through the door in Enforcement. I didn't have a choice about which branch I wanted to go into. My first branch chief was Scott Friestad. My first assistant director was Linda Thomsen, who went on to become the Director of Enforcement. Because I was a newbie walking in the door, I was paired with a more senior lawyer in the division.

People had mixed views about the honors program. Some people believed you should first go to a law firm, or go elsewhere and get experience and then come to the Commission. Others believed it was a valuable recruiting tool, and that they should try to

get the best and the brightest out of law school who were interested in enforcement. It was hands-on training: they pair you with a more senior lawyer who was in the midst of an investigation—for me it was an insider trading investigation—and you work with that lawyer so that you could learn how to do an investigation, learn the ways of the Commission, the methods that they used. And so there was someone there that you were paired with who could explain things to you, and you can watch the process unfold.

WT: So the different branches have specialties that they work on?

FP: At that time they weren't the specialized units that there are now. There was a branch that focused on microcap fraud, for example. John Stark had a team that focused on cyber fraud.

WT: Cyber fraud, Internet scams, that sort of thing?

FP: Yes, sleuthing out fraudulent conduct that occurred over the Internet. You had your go-to people who specialized in insider trading cases, and so if you had an insider trading case everyone would say, "Oh, go talk to Hilton Foster," because that's what Hilton did. But the specialized units, as they exist now, did not exist when I started in 1999.

When you started, you were an enforcement generalist. On any given day, you could have an insider trading case on your docket, an accounting fraud case on your docket. Some people were doing FCPA cases back then, but it really was, okay, so what's the

case that's assigned to you? What's the case that you've discovered through reading the newspaper that you want to pursue? So, it really was being a generalist.

WT: Just to get my chronology right here, what year was it that you went over to the Chairman's office?

FP: I went to the Chairman's office in 2002.

WT: So you spent about three years there?

FP: Three years in Enforcement.

WT: What other kinds of cases stand out in your memory?

FP: Shortly after I joined, the financial fraud taskforce was formed, and that was the brainchild of Paul Gerlach and Paul Berger in Enforcement. The idea was that these accounting fraud cases took sometimes years to build. On average, it took nineteen months to bring accounting fraud cases, and we were looking for a way to have a select team of both attorneys and accountants who could triage these cases, so they could work on them full-time. They could try to bring them faster, because you may have had six lawyers and six accountants. Then you could also divide the case up by subject matter, for example. One group could focus on the reserve issues, and one group could focus on the goodwill issues. Or, if the company was a multi-national

company with subsidiaries around the world, then you could get one group to focus on the aspect of the case that was in Mexico, or in the UK. The idea was to triage and lessen the timeframe in which those cases were brought.

WT: This was a particular priority of Chairman Levitt's. Did you have any sense of what was going on at the high level of the Commission, as far as interest in that particular subject was concerned?

FP: I would say that at that time, just coming in as a staff attorney, you paid attention to the speeches that were being made by the Chairman and other Commissioners. What I remember from Chairman Levitt's time is that you did not want to get caught off guard by news that was in the newspaper, where you would get the call, "What is the SEC doing about that?" whatever the issue was. And it's the same now. You never want to be caught off guard in terms of regulation or enforcement, because you're viewed as the agency that's asleep at the switch. Coming straight out of law school, I didn't really have a view of what was going on at the Chairman's level or the director's level, but you knew what the priorities were at the Commission.

WT: After all, you were on this new taskforce.

FP: Exactly.

WT: Tell me a little bit more about how this taskforce worked in terms of sniffing out cases. You had the accountants on the team. Were they instrumental in that?

FP: Cases would come in in a number of ways. You get a lot of press these days about the whistleblower provisions, but the SEC was the agency that always received tips from people on the inside, or from people in the industry. One way in which the financial fraud taskforce would receive cases on which to work would be through tips that came in. The other way was through journalism. The *Wall Street Journal* and the *New York Times* business sections were always good fodder for cases. If a company issued a restatement, it's almost a given that a matter will be opened by the SEC, so that was another way.

You would look across the industry. People talk nowadays about doing these industry sweeps, but it's always been around that if you had one practice in a certain industry that, maybe because—goodwill, for example, could be one, but if one large industry company was using their goodwill accounts in a certain way, or accounting for goodwill in a certain way, I should say, then you would look to see whether the other big industry players were also doing that. So there were a number of ways in which cases would come to us.

WT: Tell me a little bit more about some of these accounting tricks that you saw. You mentioned goodwill a couple of times. I know there were the cookie jar reserves, you'd see these pro forma statements, but what was really prominent on the ground level?

FP: You really looked for one-off accounting items and off-balance sheet transactions—something that came into play later with Enron—so reserves were always, always a big issue. Foreign currency transactions and the way that those were booked, and using the fluctuations in currencies was an issue. Goodwill I mentioned.

WT: So you pulled out the chapter you've written on the subject, and there is lots of good stuff in there.

FP: We've been working on a PLI book on SEC enforcement, and I wrote the chapter on accounting fraud. So your question was timely, as this book is going to be published soon. For the chapter I wrote on accounting fraud, we went through all the accounting fraud schemes that have come into play, such as basic improper revenue recognition under SAB 101 side agreements, where you have a contract, but then you write a side letter or side agreement for incentives to induce the buyer to enter into the transaction at a certain deadline so that you can book the revenue early, for example. Or, where there are multiple elements of a contract, and you have to perform the elements of the contract before you can book the revenue, but you ignore all the elements of the contract and book the revenue prematurely.

Leases are always a huge issue in terms of when you can actually account for lease payments. There were bill and hold transactions, and channel stuffing, where basically, if you're a supplier, you send out more equipment than would necessarily be needed by your distribution channel, but you ship it out early, and you ship it out often, because as

soon as it leaves the dock, then you book the revenue. So those are some of the additional accounting schemes that crop up in accounting fraud cases.

WT: In the development of these cases, obviously to investigate them in the first place there has to be something questionable on the books. Is it clear from, say, the disclosures that there's something that doesn't add up. Or does it usually come in the discovery phase that you really turn up all of these different...

FP: It really does depend on the case. With channel stuffing cases, eventually what happens is you can only ship so much product or equipment before the equipment is returned to you, so you have to take a write down; it's the element of surprise, there's a disclosure that's a surprise to the marketplace. The market asks, why all of a sudden is this company taking this \$100 million write down, and no one knew that it was coming? It's not related to litigation. It's because, all of a sudden, we had unexpected shipments returned to us. Well, that usually is a signal that potentially something is awry in the shipping arrangements, or how the company booked the revenue in the first place.

So it depends in each case. And, restatements, another signal that something could be wrong. But in a case where you're looking across industry, you do look closely at the disclosures across the industries to determine whether something is an industry practice versus a one-off by a particular company.

WT: Would you see a full range of sophistication, like people who had clearly put in a lot of accounting chicanery to cover things up, versus people who had just kind of swept it under the carpet and eventually the house of cards fell down?

FP: There's a combination of that. You can see some cases where, I mean, you're really looking at what's the tone at the top, versus a case where—sorry, when I say tone at the top I mean what's the instruction coming from on high, the CFO level? For example, if there is a projected revenue or EPS that the company projected, everybody knows we have to manage to that number so we're going to make \$1 earnings per share in the second quarter. The CFO, for example, can see that we're not going to meet that. Then, all of a sudden, it's what do we need to do in order to meet that number? Do we release reserves, because we have these cookie jar reserves that we can then release to make our earnings look better? And does that instruction move from the CFO's office, the controller's office, down to the subsidiaries and to the controllers of each of the subsidiaries? So that's one example.

The other example, where it's not as sophisticated, is you have a subsidiary of a multinational U.S. corporation who is sitting in country X, who doesn't clearly understand U.S. GAAP, and so, they're booking transactions one way, and the way in which they're booking those transactions may not follow U.S. GAAP rules. Maybe the mistake is found, maybe the mistake is not found until that person goes on vacation, or that person passes away.

I remember one case where there was a controller of a non-U.S. subsidiary who passed away, and all of a sudden the books didn't add up, and it was only because that person was no longer there that everyone was like, "What's wrong with the books of this subsidiary?" But then you also have not only an accounting issue, a potential accounting fraud issue, but you also have an internal controls issue for the parent company, because there should have been some controls around that subsidiary and that controller.

WT: Would you get cases where—maybe this wouldn't have come to you—a company would realize that something had gone wrong and essentially turn itself in?

FP: At the SEC and in enforcement there are these Section 21(a) reports, which gives companies—and that's the Seaboard 21(a) Report, which gives companies guidelines in terms of self-reporting, self-investigation, self-remediation. And so, under Seaboard, you have the opportunity to come in, once you have discovered wrongdoing, to tell the Division of Enforcement, "This is what we found." So you self-report.

What you want to do—and this is now speaking from the perspective of defense counsel—is you want to come in, say, "This is what we found, this is what we've investigated, this is the remediation." And remediation can be a combination of firing employees, retraining employees, it could be amending and enhancing internal controls, policies, and procedures, and working with your entire financial organization, as well as your auditors, to fix the issues that you've found. And so, under the Seaboard principles there is the ability to do that, and to come in and to report to the Commission. And

Seaboard expands beyond accounting fraud cases. You can do that for FCPA cases, you can do it for disclosure cases, so it's beyond accounting fraud type cases.

WT: This is, of course, probably a little bit before the dot-com bust, and so it's a very aggressive era, shall we say? Did that happen often, that they would take advantage of that opportunity?

FP: I don't recall many Seaboard reports being issued while I was there.

WT: Another thing that comes along later, of course, is Sarbanes-Oxley, and one of the key provisions is that the chief executives have to sign off on their statements. So before that happens, to what extent would you be able to extend the cases up to that level? Would that have been a barrier? Would they have been able to get out of it?

FP: The Sarbanes-Oxley certification, no. If you go back and look at the accounting fraud cases, you see that where the evidence led the staff, that's where the staff would bring the case. And so, it would go all the way up to the CFO, and maybe it went to the CEO, if you had evidence that they were involved in manipulating the company's finances in a way that they wanted to meet their revenue projections, or meet their EPS goals.

I was on the staff and part of the Financial Fraud taskforce, and actually filed the action in the Xerox Corporation matter in the southern district of New York. In that case, we settled with the company. It was a \$10 million settlement. It was the largest penalty for a

public company at its time. Saying \$10 million today is like something to sneeze at, but at the time it was the largest penalty brought against a public company. In that case actions were also brought against the CFO of the company, as well as the controller. Sarbanes-Oxley added what I'll call a nice bow. There was never a time when, if the evidence didn't lead you to the CFO, the CEO, the chief accounting officer, then, if that's where the evidence led, that's where we'd bring the case.

WT: With a big case like that, with Xerox and seeking such a high penalty, was there any more intense engagement with the Commission with those sorts of cases?

FP: No. When it comes to the investigative process, the Commission does not get involved in the investigation. There are ideally two times when the Commission gets involved, and that's during the formal order process. The staff should seek Commission approval to get a formal order so that it can issue subpoenas. Sitting here today in 2015, that has been delegated to the Division of Enforcement itself, to the director and the associate directors in Enforcement, but during my tenure the approval of formal orders so that you could issue a subpoena went to the Commissioners. So, in that example, the Commission would know a very small detail about the case, that it's against company X, we're looking into potential securities fraud violations. The staff would have to justify why we needed subpoena power.

And then, in the second instance, the next time the Commission should hear about the case should be at the time when you're recommending some type of action or you're

bringing forth a settlement, and the Commission has to approve it. Otherwise, it's a hands-off process. The Division of Enforcement investigates, and the Commission gets involved at the point where some action is being taken.

WT: When one is recommending a penalty, what sorts of considerations go into that? Is that partially an accounting decision in terms of measuring the scale of the damages? How does that work?

FP: In trying to figure out the penalties, of course, there are guidelines in the securities laws. Again, it depends on the type of case, if it's an insider trading case versus an accounting fraud case. When it comes to an accounting fraud case, you really want to consider, when you're thinking about practical considerations, it really is about how much damage did the company do? One of the considerations that a lot of people think of and, it's a little bit of a double-edged sword, what were the losses here to investors? And we're not thinking necessarily like securities class actions, but considering what would be a meaningful penalty, so that you can deter other corporations, and do something meaningful enough so that the officers, the directors, the shareholders of that company, they are aware and know that this is serious.

The reason I said it's a double-edged sword is that the other side of the argument is that, where you've had an accounting fraud case—oftentimes, because there's a restatement, for example, or there are losses that are involved—the present day shareholders whose stock price was at sixty, and the announcement is made that there's a restatement, you see

the stock price is halved, so you're down to thirty. And so the thought is, did the shareholders suffer enough? And you're taking more money out of the company's coffers; is that really how you should penalize the company? Or, is it that you should penalize the individuals who were acting, you can say on behalf of the company, but the individuals who were acting for the company, the individuals who took the actions that have now caused the stock price to be halved? Is it the CEO? Is it the CFO? Is it the controller, the chief accounting officers? How are you going to penalize those individuals so that the actions that they've taken you know you are taken seriously?

WT: I know that one of the things that Chairman Levitt was trying to do—and Dick Walker was telling me a little bit about this—at the macro level is you're attempting to tell a story that would be persuasive, say, to people in Congress, or to develop a legal framework using a series of cases. Did you have any perception of that at the level that you were working on with this taskforce?

FP: That probably didn't trickle down to the staff attorney level. I don't remember that being something that I was cognizant of. I know that, as Chairman, Arthur Levitt was very much in touch with what public perception was at the agency. So hearing you ask me that question, it wouldn't be surprising that that was one way in which he was trying to get the message out about the mission of the Commission.

WT: Tell me a little bit about the shift that happens with first the economic recession, but around the same time, then, when Enron hits, and then the subsequent events. How did that change things with what you were doing?

FP: I don't really get what you mean by the shift.

WT: Well, you're working on a series of cases that are a priority of the Commission, but that aren't really seen so much by the public, that aren't in the press, and so forth. And also, they're not maybe quite at the scale of the Enron implosion. They didn't take down Arthur Andersen, that sort of thing. What was the environment like after that? Was it substantially different from where you were coming from?

FP: I can say that anecdotally, and sort of as a social experiment, that when I joined the Securities and Exchange Commission, many of my peers and people who weren't on Wall Street and who weren't securities defense lawyers, for example, did not have an awareness of the SEC. And so you would say the SEC, and many people would say, "The FCC? Which agency do you belong to?"

And so when the Enrons and the WorldComs of the world hit, then there was a real shift. Everyone knew which agency you worked for, and everybody knew what your agency did and what cases your agency was responsible for. Because suddenly, you had a huge impact on—well, not even a huge impact, you had the publicity that the agency received, as WorldCom and Enron hit, at a level that it hadn't been at since Michael Milken and

Drexel. You had a new generation saying, “Oh, okay. I know which agency you work for now. You’re the agency that investigates Enron or WorldCom.” So there was definitely a shift.

WT: Did the kinds of cases that you personally worked on, were there changes in those? Did they get bigger? Was there pressure to seek higher penalties?

FP: By the time Enron and WorldCom came, I had moved from the Division of Enforcement to the Chairman’s office, and so my role within the agency had changed. In Enforcement, I was investigating the cases. We brought Xerox. Avon was another large accounting fraud case, as well, that the financial fraud taskforce brought.

Once I moved down to the Chairman’s office, then it was you’re no longer investigating the cases, but you’re helping the Chairman drive the policy, and you’re assisting with the enforcement policy of the Commission. I had a much more holistic view of the Commission, with the interplay between Enforcement and Corporation Finance and Market Regulation (which is now Trading and Markets), the General Counsel’s Office, the Office of the Chief Accountant. So now what I was doing was a lot different than when I was in Enforcement, where I investigated matters.

I got a little taste of working with other agency offices when I was in Enforcement, because I helped out with some Sarbanes-Oxley rulemaking. The rule with respect to the improper influence on audits and auditors, and then the retention of audit records, I

helped draft some of those rules, and so that gave me a much broader perspective of the Commission. But once I moved down to the Chairman's office and the Enrons and the WorldComs hit, then it was a much more—like I said, all eyes were suddenly on the Commission, rather than just this little agency that only Washington and Wall Street cared about.

WT: Tell me how you made that move. How did that opportunity come about?

FP: I had been doing accounting fraud cases for a while with the financial fraud taskforce, and I was talking to Steve Cutler about other opportunities. I wanted to do something more than investigations.

WT: Was he still the deputy at that time?

FP: I can't quite remember when he became deputy versus director. And so one project, Steve asked me to represent Enforcement on some Sarbanes-Oxley rulemaking. Because at the time, the deadline was coming up fast, and there was lots of rulemaking to happen, similar to Dodd-Frank. And so I had first worked on some Sarbanes-Oxley rulemaking, as I just mentioned. And then, one day Steve came to me and was like, "The Chairman needs a new enforcement counsel. Is that something that you're interested in?" And so you don't say no to that opportunity, unless you really want to stay in Enforcement and investigate. Some people really want to do that. And so I said yes, and met with

Chairman Pitt and I think maybe his chief of staff at the time, Mark Radke. We met, and shortly thereafter Harvey offered me the job.

It was, of course, an interesting time to be in the Chairman's office, because, as you said, Enron, Martha Stewart, WorldCom, Vivendi—just a lot of interesting, big cases coming down the pike. The research analyst cases were in the mix. Eliot Spitzer was using the Martin Act in New York, and the states were becoming much more interested and active in securities cases. So it was an interesting time to be there.

WT: How many people were you working with? Were you just the one person who was aiding him on enforcement, or what does the Chairman's office look like?

FP: At that time—and it changes with each Chair—Chairman Pitt had a chief of staff and a deputy, a speechwriter, and four counsels. I was the enforcement counsel, but I wasn't the only one who handled enforcement matters, and we can talk about that. There was someone whose primary responsibility was the Office of the Chief Accountant and Corporation Finance, someone else who focused on the market structure issues. I know I'm missing somebody. There was at least one other person who I can't remember what he did; Investment Management, that's what I'm missing.

WT: What, in general, were your responsibilities, then, to the Chairman?

FP: My primary responsibility, which occurred on a weekly basis, was helping to manage the enforcement calendar. The Commission would have closed meetings in which they vote on the matters that Enforcement brings before it, the second part of the process that I talked about where the Commission gets involved. At any given time the calendar for the closed meeting could have between ten and fifteen cases. I had to ensure that it was a manageable caseload, and at that time, the Commission was still voting on all formal orders, and we came up with a streamlined approach to dealing with formal orders, which was to get them to the top of the calendar, figure out if there were any that had any issues. If there are, let's discuss them, try to iron out some of the issues that presented themselves before getting to the closed meeting, and really just making the formal order consideration more of a streamlined process.

Before I went to the Chairman's office, formal orders were done in a seriatim type manner, mainly, which was it went from one Commissioner's office to the next. Sometimes it started in the Chairman's office, and then went around to the other Commissioners' offices, and sometimes they would languish in an office and you had to go figure out where is it, and is there a reason why it's just sitting there, or did it just get lost under a pile. In order to streamline that process and make sure that Enforcement was having access and the ability to issue subpoenas and get its job done, we just made it a much more streamlined process and put it as part of the closed meeting process. As I said, that's changed now.

And then came the more substantive part of the meeting, which is that Enforcement has some settled cases, we have cases that we're going to litigate: here are Enforcement's recommendations, these are the violations, and here are all the policy considerations. Each Commissioner, just as each Chairman, has policy issues that are important to them. One of the issues that I recall that would come up during the time that I was there was whether Enforcement was bringing a case in which the Commission didn't have either clear guidance out to the industry, or there was no rule on the books that made whatever conduct the Division of Enforcement was alleging an actual violation. It's what I call rulemaking through enforcement. So, you bring a case against a company where you allege a violation that may fit under Rule 10b-5, but it wasn't necessarily clear to the industry that that was a violation in the first place. I remember that being a huge issue at the time.

There was also, of course, the penalty issue, the item that I mentioned about the tension between bringing a huge fine against the company because you want it to act as a deterrent versus whether you should bring a fine against individuals and individual liability. And so we worked on some framework around penalties, the factors that you should consider when you're bringing a penalty against a company, versus the appropriate time to bring it just against individuals. And so my job as enforcement counsel was to get the action memo from the enforcement staff, review and analyze the issues.

I was the enforcement counsel for two Chairmen, so what I did was very different for Harvey Pitt versus Bill Donaldson—Harvey Pitt, the Zeus of the securities laws, versus Bill Donaldson, who came from the business side. Harvey wanted to know, “What are the legal issues that I should be considering? And then, were there any issues that the other Commissioners had that we need to discuss at the table?” For Bill Donaldson, it was, “Okay, talk to me about whether this is a fair settlement. I’m an executive, so I need an executive summary of the actions. I’m not a lawyer, so don’t give me a lot of legalese, because I really want you to digest the information, analyze it, and give me a recommendation.” For both of them your job is to give them a recommendation on how you think the matter should be voted on. But at the end of the day, the Chairman makes up his or her mind. That job meant two different things with two different Chairmen, so that was interesting.

WT: That’s really fascinating. I actually was talking to Peter Derby last week, and he was telling me all about these dashboards and so forth that he put in. In the more management of the caseload, et cetera, side of your job, was that something that you saw, as well, or was that not so geared towards enforcement?

FP: No, what Peter did in terms of the dashboard and the management of the agency didn’t really impact the analysis of the cases.

WT: I see. So obviously, as we were discussing earlier, you’re in a much more prominent and public SEC environment, and of course there’s a lot of criticism coming at the SEC, and a

lot of pressure to come down hard on people who violate the rules. Did you see a lot of that pressure coming in from the Hill, maybe from the executive branch? And was there a need to mediate between that and the actual process of the penalties sought, and so forth?

FP: I'd just say that the agency, I think, always had pressure from the Hill, because at the end of the day that's where your funding comes from, that's who you have to justify your existence to. But I think the increased pressure that I see now didn't exist as much as it did then. I think during my tenure, I would say that I really felt the agency operated as an independent agency. You did have the pressures of making sure that you weren't caught behind the wheel not realizing what was happening in the industry. You always had that pressure. But now I see a real tension between the various factions on the Hill, and so I think just the tone of the agency has changed.

The mission of the agency to be the investor advocate, to protect investors, I always felt was, during my tenure, the number one priority. And however we needed to get there, whether it was through rulemaking or enforcement, then the Commissioners and the staff of the Commission would work to fulfill that greater mission, where now I see it more as a sort of pawn in the political game. So I see much more of partisan politics in the agency, which causes a lot of gridlock.

Not everybody agreed with Reg FD when it came down, but somehow there was a rule, there was compromise, it got done. And even when the first cases came out, which I

think were 2003—and there were a group of cases, I think six cases that came out at the same time—even though some people still didn’t agree with Reg FD, it was on the books, it was a rule.

It was a rule, and so it was part of the Commission’s mission to ensure that the rule was enforced. Enforcement found the cases. There were varying degrees of the settlements in those cases. I think one company got a C&D, one company settled with penalties, and one settlement in which the CEO received a penalty. But the Commission voted at the end of the day that those cases should go forward. And Reg FD, somehow, even though not everyone agreed, still became a rule, right? Where I think today—and you can see it with Dodd-Frank—there’s just a lot of gridlock within the Commission, and so you just wonder whether the agency has sort of lost sight of being the “investor advocate” and our number one priority is protecting investors.

WT: In pursuing enforcement cases and in size of penalties like you were talking about earlier, there are of course different philosophies on the Commission in the early 2000s, and I know that there were some three-two votes. Is it the case that there would be discussion on the Commission—or between the Commissioners and staff, I guess, because of the Sunshine Act—as to exactly how this was going to get hammered out? Or would it just be a case that it would go to the vote and the three would win, in cases where it was split?

FP: That definitely depended on the Commission. I think when I started at the Commission, and not having any experience with it, but I think there was an understanding that cases

would get worked out, and things would get worked out behind the scenes before something went to vote. And so you did have a lot of people working to make sure that you found some compromise with respect to rulemaking or an enforcement case. And then there were some cases where you would just go in, and the Commission would vote, and the chips would come down wherever they came down, because there was an inability to get to compromise.

I don't remember a time—not that it didn't happen, but I don't remember a time during my tenure where a Commissioner would issue a dissenting opinion. That's something that you see more and more now. It depends on the Commission, but I actually feel like if we can get to a place of compromise with respect to enforcement cases and rulemaking, then we can swing the pendulum back to the appropriate middle ground.

WT: You were talking a little bit about Reg FD, and of course we have Sarbanes-Oxley in this period, as well. Did those rules and the rules that came out of Sarbanes-Oxley have a substantial impact on enforcement policy or the kinds of cases that were brought?

FP: I think Sarbanes-Oxley definitely emboldened the Commission, because at that time they got a lot of what they wanted from Congress put into Sarbanes-Oxley. And a lot of things were addressed that the Commission felt needed to be addressed, based on the experience with Enron and WorldCom. For example, the rule that I worked on, improper influence on audits, someone felt there needed to be an actual rule about how people behaved towards auditors, for example. And the language in the rule deals with threats

and intimidation, so I think the staff felt emboldened by Sarbanes-Oxley. They got the CEO, CFO certification that we talked about earlier. Sarbanes-Oxley also helped deal with one-off transactions, off the books transactions, so I think it just emboldened the staff and helped deal with a lot of the corporate governance issues.

WT: And the SEC actually receives some more resources in this period, I think. The budget goes up.

FP: That's right.

WT: They're able to hire a few more people. Did that play into that, as well?

FP: Within the agency you felt like, "Okay, we're getting the exposure that we need, but now we're actually getting the resources that we need, too." So you can invest more in your staff, invest more in technology, so that you're not so far behind the curve. I believe the increased budget and the increased staff definitely helped the caseload. The morale at the agency was high at the time. So all those things helped.

WT: Would it be a tendency to take more cases, or to put more effort, or resources, personnel into the cases that you did take; maybe a bit of both?

FP: I don't think how many cases you had were driven by resources as much as the quality of the case and what impact the case would have in terms of serving as a deterrent. I think

having more bodies in the building meant of course you can bring more cases, and it helped with the Division of Corporation Finance, because you had more people looking more closely at disclosures. And when you have the disclosure process in Corporation Finance, if that process where the analysis of a company's disclosure is not worked out through Corp Fin, then, there's a referral to Enforcement. So if you have more bodies in Corp Fin, and you have more bodies in Enforcement, then that referral process can be much more robust, I would say.

WT: I'd like to come back to something you mentioned earlier, which of course is the variety of regulators and prosecutors who start to go after—of course I'm referring to Eliot Spitzer, the other state prosecutors. Of course, you're always collaborating in certain cases with the FBI, for example. Could you tell me a little bit about that collaboration, and particularly the degree to which that was driving cases?

FP: It's funny, because I remember when I started with the Financial Fraud taskforce, we had some cases where we wanted the FBI to get involved, and we wanted DOJ to get involved, and you couldn't get them involved in accounting fraud cases for whatever reason. Maybe for them it was a lack of resources. When people think of accounting fraud cases, they don't think of them being the "sexiest" cases. But there was a time when you couldn't get the criminal authorities to really take a lot of interest in securities fraud cases, at least the ones that I was dealing with, which were the accounting fraud cases.

When the WorldComs and Enrons hit in the 2002 period you saw a real shift in many agencies, and many different regulators getting involved. You had both the criminal interests, and of course under President Bush, there was a taskforce that was formed between the DOJ and the SEC to deal with Enron-type issues, so now you had more agencies collaborating.

We worked on a number of MOUs with other agencies at that time. I remember there was one between the FDA and the SEC. Because you wanted to have more of a collaborative process with the other agencies, so that you could learn more about their process to figure out how it may impact your enforcement case. I remember there was a case with a startup pharma company, and you wanted to know more about the disclosure process and how the FDA approval process would impact their blockbuster drug. You found that you wanted to have the ability to call up someone at the FDA and say, “I’m looking at X, Y, and Z Company, what can you tell me,” and have it not fall on deaf ears, and that there was a process and a procedure around that. During that time, there were many more MOUs, or just letters of—I don’t know if the right word is letters of cooperation, but you found that within all the various agencies, that there was more of a collaborative process.

WT: I know there was a lot of tension between Spitzer and senior people at the SEC, largely on account of Spitzer’s rhetoric, “asleep at the switch,” so on and so forth. But at a lower level, between his staff, say, and the staff at the SEC, did that impinge on their ability to work together?

FP: That's a good question. I can't say that I had any visibility into that. By the time I got to the Chairman's office, it really was a matter of Steve Cutler dealing with Eliot Spitzer, and that's the level that I had transparency to. So, I don't know how it worked at the lower levels, actually.

WT: There were a couple of different very prominent sets of cases in this period. You mentioned beforehand that you didn't have a front row seat to the broker-analyst conflict cases, but then there are the mutual fund cases—late trading, market timing, that sort of thing, which also became very prominent I guess in the 2003-2004 period. I'm wondering if you could tell me a little about your experience with those.

FP: I think I mentioned earlier, at least when we were talking about the accounting fraud cases, that there are times where you look across an industry to figure out whether it's an industry practice versus just a one-off. The market timing cases was an example where it was somewhat of an industry practice. Again, I wasn't on the staff that investigated the cases, but you had a number of investigators, attorneys within Enforcement, who were looking across an industry.

In the Chairman's office and at the Commissioner level, you're not involved in the day-to-day management of the cases, and so you really do see them when the staff has made a decision about whether it's time to bring a case, and what types of cases are you going to

bring. Are you bringing a settled action? Is it going to be an administrative proceeding? Are you bringing a matter that going to be litigated in district court?

Again, it was one of those very high profile cases. It was one of those cases where you looked and said, "Is there a rule, and is the rule clear?" So, does everybody understand what the rule is? And this was one of those instances where it was clear that there a) was a rule on the books, and b) the rule is pretty darn clear. We had the added pressure of Eliot Spitzer, and so it was a time of high stress. We've moved from Arthur Levitt, to Harvey Pitt, to now Bill Donaldson as the Chairman, and I just recall that it was a pretty clear cut; those were pretty clear-cut cases to bring.

WT: When you'd have these industry significant cases, and also things like Enron, WorldCom, et cetera, how much of the attention of the chairman would that take, versus your kind of standard, run of the mill sorts of cases that they would have to deal with as a matter of course?

FP: Those cases are higher stakes, and so there are other things at play, like the integrity of the staff, and the integrity of the Commission, making sure that there's no perception that there's any improper or outside influence on the cases become increasingly important, making sure that Commission investigations stay confidential. I remember a couple of instances where things about investigations would end up in the newspaper prior to either the Commission taking action, or the staff coming to a decision about the case. And so

you did feel more pressure, with those types of cases, to ensure that the integrity of the Commission was intact.

With Enron, it was all eyes on you. With the market timing cases, this is also all eyes on you. The Commission in no way, shape, or form wanted to be viewed as too close to the industry. Whether it was the mutual fund industry, whether it was investment banking, you just didn't want to be viewed that way. So as the cases impacted more and more people, and you got more and more exposure in terms of press, or more attention from the press. There was increased pressure on everybody to make sure that we were doing the right thing.

WT: As a bit of a follow-up, would you be able to see interaction between what happened in Enforcement and subsequent rulemaking in the relevant areas? So, you had the Arthur Andersen case, and then the Sarbanes-Oxley rulemaking that followed that, mutual fund cases, and then later on—this may have been after you left—but they wanted to do the new rules for mutual fund governance. Would you be able to see that kind of intertwining into the thought of the Chairman? Maybe it's too abstract a question, I'm not sure.

FP: It is a little bit abstract, the question, and I think it actually, depending on the circumstances, it comes up in different ways. So where you notice that there is a vacuum of rules in a certain area, then one way to deal with it is to perform a study to determine

where are the gaps, what are the issues, and then you go through the rulemaking process, and then you bring the enforcement action.

One of the two studies that I remember when I was there was that's when we started to take a closer look at the hedge fund industry, and what they were doing, how much money was under management, et cetera. And then there was also the study on Class A shares versus Class B shares in mutual fund companies. And again, you do a study. You have open meetings where industry experts come in, and you have roundtables, and there's a discussion, there's a give and take between the agency and the industry, and then you go to the rulemaking process.

And then there's the other way around, which is you bring an enforcement action, and then you have the rulemaking. I think there's a lot of give and take about whether enforcement should come first and then rulemaking. The idea, I think, and when people add in considerations of due process, et cetera, is that I think ideally—and sitting on this side now, in the defense bar—ideally we'd like guidance first, so that the industry knows what it has to do, whether it's an public company, investment banking, mutual funds, hedge funds, whatever it is. You'd like to have the guidance first, so that everybody is on the same playing field. And there are various ways in which the Commission can do that, through roundtable discussion or studies or you can use OCIE to collect facts and statistics.

In Enforcement, I mentioned the 21(a) reports with Seaboard in which you lay out a framework for people to know this is how we expect you to conduct yourselves with respect to self-reporting, self-investigation, remediation, and then cooperation. There are various avenues that you can take, or various methods of getting out guidance and rules, before you take an enforcement action. So that's a little bit different way of answering your question, but I think that a lot of people are thinking about these issues.

WT: Getting a little bit back to what I was saying about states versus the SEC, there's also the SEC and the SROs, and even within the SEC, there's regional offices versus the Washington office, in terms of parceling out who gets to take what aspects of a particular enforcement action. Could you talk about that? Let's take it one piece at a time.

FP: Let's take the various offices. It's funny, because I remember coming into the Commission as a newbie and sort of thinking, "How is it that the New York office is doing that case, versus the Miami office or the home office?" for example. Because if you look back to one of the one of the big accounting fraud cases, Vivendi, that case came out of the Miami office. I remember being at the Commission very early on, that one of the things that you did was you wanted to be the first one to peruse the business section, *New York Times*, the *Wall Street Journal*, and if you got there first and could open a case first, then it was your case, regardless of which office you were in.

And sitting here today, in the defense bar, and knowing that the Enforcement Division has these more specialized groups now, even though the complex financial instruments

groups is based in New York, there are elements of that group here in Washington as well, and there are elements of that group in Boston as well. At least those are the three offices that I deal with. But you know it's going to be, at least for me, one of those three offices.

Then with the municipal securities, that foothold has always been in Philadelphia, and so many of the cases come out of Philadelphia. And now with the MCDC initiative, you do see Philadelphia again spearheading it, because that's where the head of the group is, and the deputy of the group is. But you see folks from the Boston, Philadelphia, and Washington office working on those cases. I know I sound East Coast-centric (laughter) during this conversation. I don't want to leave out the Miami or the San Francisco or L.A. office, but the offices I mentioned are the offices I tend to take notice of. So I think the agency has shifted from one where offices compete with each other, to one where, based on subject matter and interest, they work more seamlessly across the country.

WT: Then outside of the SEC, I guess a lot of it has to do with what enforcement tools are available to, say, a state regulator, or to an SRO. These are a bit closer to the markets. Can you tell me about that?

FP: Well, for all states there needs to be some nexus between the alleged activity and the state. One of the tools that Eliot Spitzer had that was available to him was the Martin Act, and so with the Martin Act he was able to do more than any other state was able to do. Because he dusted that off, he had the ability to go after Wall Street. We see the

states more and more active—and this is speaking as defense counsel, as well. Any time there was a settlement with one of my clients and the SEC, or even with FINRA, we were anticipating a call from either the state in which the client is domiciled, or the state where they do a lot of business. That could be New Jersey; it could be Connecticut; it could be Massachusetts; it could be North Carolina. But we more and more expect that call, and, as defense counselor, our job is to say there's no nexus between the state and the conduct, or the state and the people who have been alleged to have been harmed.

But with something as powerful as the Martin Act, Eliot Spitzer was able to do a lot. Not a lot of states have anything that come close to the Martin Act, but they find other ways to become involved in the action in which you just settled, either with FINRA or the SEC.

WT: I think it was Dick Walker who was saying also that, with people like Spitzer, they can really take their own initiative, whereas at the SEC, there are five Commissioners who, at least the majority of them have to be persuaded.

FP: That is very true, you can't; it's a checks and balances system.

WT: Are we missing anything? I think I'm to the end of the questions that I wanted to be sure and ask you.

FP: I don't think so.

WT: Terrific, well then in that case, let me just ask you very quickly about moving into private practice and the adjustment to that, what that's been like for you?

FP: Well, it's been a few years now, so the distance between myself and my younger self at the Commission is a lot greater now. But I remember leaving the Chairman's office after my time at the Commission, and one of the things—I was actually telling someone this story this week—that I missed when I walked out the door was the ability to know what was going to be on the front page of the *Wall Street Journal* the next day, or the next morning.

When you're in the building, you're steeped in the securities laws and what's happening on Wall Street, and you learn by osmosis. Because you can walk two doors down—and when I was in Enforcement, if I'm working on an insider trading case, the person next to me could be working on an FCPA case, and when you had your weekly meetings with your team, you're learning about what they're doing and what issues they're facing.

When you move to the Chairman's office, it wasn't only about enforcement, but I also needed to know more about Corp Fin, and I needed to know more about Trading and Markets, and I needed to know more about IM. And so the building, at least when we were on E Street, you just learned through osmosis, because there were so many brilliant minds in the building discussing the pertinent issues of the day. That's actually one of the things that I miss about the agency.

WT: Okay, so I guess that should wrap it up, then, unless there's anything else.

FP: Thank you. It was a pleasure.

WT: Thank you very much.

[End of Interview]