**Bingham Presents 2012: Criminal Enforcement of Securities Laws**
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**LISA FAIRFAX:** Welcome to Bingham Presents 2012: Criminal Enforcement of Securities Laws, broadcast live from Bingham McCutchen LLP in New York and online on www.sechistorical.org. My name is Lisa Fairfax and I am the Leroy Sorensen Merrifield Research Professor of Law at The George Washington University Law School, and I am going to be the moderator for today's program.

This program is the fourth in the Bingham Presents series and it is made possible through a partnership between Bingham McCutchen LLP and the SEC Historical Society. With more than 1,000 lawyers in offices on three continents anchored by major commitments in the world's key financial centers, Bingham McCutchen LLP offers market leading practices focused on the financial services industry. The SEC Historical Society shares, preserves and advances knowledge of the history of financial regulation through its virtual museum and archive at www.sechistorical.org.

The museum celebrates its tenth anniversary in 2012 and has welcomed more than one million visitors. The Bingham Presents series debuted in 2009 to provide insight into current issues in financial regulation of interest to the legal profession. The dedicated Bingham Presents section under Programs in the virtual museum and archive shares the previous programs in the series: "New World of Financial Regulation," which was presented in 2009; "Harmonization of the Regulation of Investment Advisors and Brokers Dealers" in 2010; and last year's "Enforcement After Dodd-Frank."

The SEC Historical Society is grateful for the continuing generous sponsorship of Bingham McCutchen LLP for the series.

Tonight we are going to be looking at criminal enforcement of securities laws. Joining me today to discuss this very important issue are Marc Minor, who is the Bureau Chief, Investor Protection in the Office of the Attorney General in New York; George Canellos of the U.S. Securities and Exchange Commission, currently Deputy Director in the Division of Enforcement and former director of the New York Regional Office; and Susan Merrill of Bingham McCutchen LLP and former Director of Enforcement for FINRA.

Before we begin I would just like to state that the views shared today are those of the individual presenters and they are not representative of Bingham McCutchen LLP, the SEC Historical Society, the New York Office of the Attorney General or the SEC.

The SEC Historical Society selected me as the moderator and I have worked with the presenters today to develop this area of discussion. So let's just begin. I want to start first with some background and context for our discussion. So I will start first with Susan to just give us an idea about how did we get here? How had the criminal enforcement of securities law evolved particularly since the financial crisis?

**SUSAN MERRILL:** Well, as we sit here today about four years after the Lehman bankruptcy where the stock market fell from 14,000 down to a low of 6,400 in just over a year, that really was the kick-off to the financial crisis fueled primarily by the mortgage bubble and the sub-prime lending. The financial crisis has brought reams of regulation. Regulatory regulation has

blanketed Wall Street since that time. Rules and laws behind Dodd-Frank have not even fully been written or implemented yet. But still there is a public perception that you read in the newspapers so often and hear even here from some halls of Congress that the people responsible for the financial crisis have not been brought to justice. The Department of Justice has brought over 600 mortgage fraud related cases since the beginning of the crisis. They have a Financial Fraud Enforcement Task Force that has been prosecuting those cases all across the United States. You have been high profile targets though and I think there is a reason for that. This financial crisis didn't easily lend itself to criminal prosecution. It was primarily brought on by a failure in judgment and risk management from those who were in the top seats of some of the banks that failed miserably because of the sub-prime crisis.

The legislation that has come out of it has attempted to address those risks and see to it that risk management is bolstered and that there are safeguards in place. But that doesn't make for good criminal case. The two hedge fund managers from Bear Stearns who were prosecuted very shortly after the financial crisis began in connection with the collapse of two large hedge funds that were heavily leveraged in the sub-prime was a colossal failure for DHA. They were acquitted. And even the SEC has seen some setbacks in trying to get verdicts against individuals in some of these sub-prime related vehicles. So it hasn't been an easy road certainly for criminal prosecutors to hold but primarily I think because of the fact that these failures were not of the fraudulent intent type which does meet itself to criminal prosecution.

**LISA FAIRFAX:** George, let me get your prospective on how we got to where we are today with regard to the criminal enforcement, you know and certainly that kind of goes in tandem with what the SEC has been doing on the civil side?

**GEORGE CANELLOS:** I think Susan's right. In general I think these are very rough areas of comparability but I think you can think of various periods in time where we had big financial crisis. There was a financial crisis which began in 2007/2008. Many of the people in the room remember well the tech bubble bursting in the year 2000 as well. And a lot of people associate the years 2002, 2003 and 2004 with accounting or corporate fraud crisis brought on initially by the revelation of the Enron fraud, then the WorldCom fraud, then the Adelphia fraud followed by the revelations of many other types of improprieties in accounting.

The middle crisis is fundamentally different from the other two in my view. The middle crisis was inherently a law enforcement crisis when Enron went from having a market capitalization of many tens of billions of dollars to zero overnight and WorldCom essentially the same. It was because there was obviously false depiction of both of those companies' financial conditions and someone had committed a very serious fraud and it really was only a question of finding out who is directly responsible in the sense of being highly culpable and acting intentionally, who was reckless, who was potentially negligent, whether auditors can catch the problem. But it was by its very nature a law enforcement crisis.

The bursting of the tech bubble, the first of the ones that I just mentioned in my view was the kind of a major business problem that left many people unhappy, and many people having a human desire for accountability. But wasn't by its very nature crying out as an law enforcement crisis like so many instances in which the exuberance of the market leads to pessimism, a bubble bursts and there is a great depression in stock price and/or the economy. Many frauds or fraudulent practices that were going on undetected in times of exuberance or that for practical purposes were very hard to enforce, suddenly became evident or easier to enforce. I mean someone who is making 30% in the S&P and perhaps fraudulently losing a percentage or two and is still making 28%, it is a little harder as a practical matter to bring such cases to the jury,

less so when there's been a huge drop. So enforceability improves and very importantly when bubbles break you reveal frauds. But it doesn't mean that the breaking of the bubble is itself a fraud. I think that the financial crisis is more analogous to the breaking of the tech bubble. There had been frauds exposed. I think there is easier enforceability of some conduct that you would always have viewed as fraudulent but that hadn't necessarily resulted in the kinds of acute loses that they did during the financial crisis. And so… but I don't think it follows from observing this crisis that you would say there is a crisis, let us go find the people who caused it and bring them to justice because its not by its nature necessarily criminal or even a securities violation.

**LISA FAIRFAX:** Marc, can you talk a little bit for us about kind of what that additional activity has been looking like particularly in kind of more recent years?

**MARC MINOR:** Sure. The fact that it is difficult to ascertain a specific individual who is responsible, it doesn't really stop the human cry for the head on a stick. But I think that the recent statistics that had been maintained by the FBI would bear out during their most recent report that which is 2010 through 2011 that there is a general trending both in the incidence of reporting a fraud and the number of investigations that are undertaken by various agencies and these are national statistics. Some of these may vary from region to region but in each of the past five years, the number of frauds being reported has gone up and over the past two years, comparing that with the prior tier of reporting cycle, the number of fraud investigations are up 52%.

Anybody who has been working in this area for a while will know that after major certain major news events, Madoff, what have you there, significant spikes in the reporting of activity, anybody who can't get in touch with their broker, you know. for a couple of days at some period of time who is reporting that. And so there was some reporting. I think also there was a shift in budget and allocation of resources at various federal and state agencies and in an attempt to be responsive to the financial crisis as it were. And so that may also explain some of that spike. But clearly the trend over the past five years was increasing of reporting, a 52% jump. I think everybody has to agree it is a significant shift and it requires a lot of attention for any law enforcement agency.

Specifically amongst the types of frauds, for securities fraud in the top five were included Ponzi schemes, reporting of Ponzi schemes. Affinity frauds has been a growing problem, states have certainly a growth in this area as the pool of potential victims has gotten smaller and smaller. But people are looking for some kind of investment, I think they are increasingly attracted by some person or group with who they have some relationship which makes them unfortunately more attractive victims for those who they might feel a greater sense of comfort. Pyramid schemes are still in the top five. Prime bank investment schemes also refer to special access schemes where they say in this horrible economy we have access to a Fed window rate or a reduced rate for this period of time for whatever reason that was very attractive for the last couple of years. And there are Ponzi schemes and promissory notes.

Specifically on the stateside what we can tell you in the North American Securities Administrative Association, we practice information and our statistics and in aggregate as well. So you see all of the schemes that you will see covered anywhere else. I will also add just mark manipulation and pump and dump to that. We see a lot of that on the stateside. We also track in terms of criminal enforcement specifically states' contribution to any criminal enforcement. And that is up 25%. We measure that as numbers of years of incarceration in the aggregate that states contribute to. And that is up 25%. It also may reflect a more vigorous enforcement by local prosecutors or federal prosecutors for either bringing those cases or unable to bring those

matters to some other conclusion. And so the census is related to that maybe longer.

And finally referrals by states to law enforcement agencies are up over last year by nearly 30%. And so with those I think we can see that there has been hyper focus and interest in the markets, the constituencies that we serve on the state level are asking for greater attention to these areas and it certainly is reflected in the data that we see…

**LISA FAIRFAX:** Whenever there is an up tick in the criminal enforcement of securities t laws, it raises the kind of question about how best to marry the enforcement of the security laws on the criminal side, enforcement of securities law on the civil side. So you guys talk a bit about where does that in, where should that in, how do those two pieces work together? Susan, first.

**SUSAN MERRILL:** Sure. Congress set it up this way that there would be overlapping jurisdiction and the securities laws being prosecuted civilly by the SEC and any willful violation of the '33/'34 Acts can be prosecuted criminally by the Department of Justice. Add to that the overlapping jurisdiction state regulators and with the SROs and you have a bit of the five ring circus. But I do think that there is a utility to having the overlapping jurisdiction. The idea is that nothing falls through the cracks and there are certain types of conducts that are uniquely suitable for criminal prosecution. For example, when hundreds of millions of dollars go missing and customers of particular firms can't find that money in their accounts that is certainly something that is appropriately within the criminal jurisdiction to at least investigate.

The problem is that I don't think that Congress envisioned the mass of duplication that you have now with virtually every high profile securities case being looked at and investigated by both the SEC and the Department of Justice. And it is not really a question of where does one end and the other begin because quite often they are going on in tandem, which raises quite a lot of the issues for people who are under investigation.

So I think there are certainly cases where it's appropriate for the criminal authorities to be involved at an early stage is indeed crucial and where criminal prosecution is really the only appropriate outcome which involves punishment and loss of liberty. But there are certainly a lot of securities cases that I have seen recently where having the DoJ jump in has complicated things needlessly in an area in which I don't think there is a realistic outcome is going to be criminal.

**LISA FAIRFAX:** George, do you have some more thought especially this question of appropriateness of criminal enforcement over civil enforcement?

**GEORGE CANELLOS:** For nine years I was a federal criminal prosecutor, most of that time doing securities frauds. So I was working with the SEC at the SEC working with my former colleagues. So you know the question, interesting question is sort of what's a criminal case?

**LISA FAIRFAX:** But a different answer now that you…

**GEORGE CANELLOS:** No. no. look I think that this is maybe too much of a generalization but a criminal securities case is a civil securities case with a little better proof and a little better jury appeal. And that's it because frankly if you look at the elements of securities fraud and I am talking about 10-b or 15-c or 17-a-1, scienter-based securities fraud, not our negligence based claims, not our failure to supervise claims. But if you look at the statutory elements of a Section 10-b civil claim they include materiality, false submission, deception and a degree of scienter, while we talk of about scienter being capable of being demonstrated through recklessness. I

think it's fair to say that prevailing appellate definition of scienter, is something very much akin to knowing misrepresentation. It either has to be deliberate intentional misrepresentation or the circumstances need to be such that it should have been obvious that it was a misrepresentation.

The only extra element that makes something criminal is willfulness and the standard for willfulness was established in the 1960s by the Second Circuit and remains the current one and it is simply having the added element of having some apprehension of the wrongfulness of your conduct. The courts make clear that when you, you don't have to know it's illegal, just wrongful so any fraud counts. Deceiving someone to take their money. Deceiving someone to sell securities is clearly by its nature involves knowing you are doing something wrongful.

So basically the elements line up. And the differences therefore become procedural ones. One, requires to be beyond reasonable doubt, also requires unanimity of 12 ordinary jurors. Any other doesn't always require unanimity though it often does, sometimes you can get to a judge and the standard is preponderance of the evidence. The other frankly important factor is civil cases. Again I am overstating it for a little of effect, are more or less infinitely settle able. Not all, but essentially there is a lot of scope of settlement of civil cases because criminal cases tend to be all or nothing. I think that that explains a lot of the difference between what is civil and what is criminal. And I mean there is a little bit of a gut sense on the prosecutor's part that this it is really bad conduct that I ought to be punishing that it is fear of putting in prison for which elevates the standard a little bit. But it is really the element of jury appeal and the gravity of the kind of 'take the money and run' quality that I think tends to elevate a civil case to a criminal case.

I don't think it is necessarily always helpful but we have in effect separate agencies or departments at the federal level invest with civil authority and criminal authority. Marc's office and he could comment on how it works in practice has both civil and criminal authority. I do sometimes think that there is a great deal of redundancy in the work, in the effort that is put in by civil and criminal investigators. Notwithstanding the seamless, excellent coordination between the SEC and the Justice Department. I think it is outstanding, as good as you could possibly hope for. But still we are doing different things. We have different objectives. We can't go over the Chinese… the ethical wall that separates the grand jury from civil cases. It is necessarily some degree of redundancy so there is some inefficiency. And also there is a little bit of a question of calibration, if you are a criminal prosecutor and all you have is nothing or criminal charge, it is possible that in coming up with a calibrated approach. If you were ultimately responsible for both criminal and civil some cases might be resolved soon when instead they were resolved through let's say differed prosecution agreements or non-prosecution agreements which are sort of quasi-civil remedies. I am not sure that Congress has done us a complete favor by separating civil and criminal enforcement. Marc?

**MARC MINOR:** I think there certainly are efficiencies that can be had. As most of you know violations can resolve in either a civil or criminal action. And so in that regard the same individuals who are digging in and investigating the extent of the conduct are the same people who will then be weighing in on whether or not the conduct itself arises to something serious enough or the amount in controversy is significant enough. The number of victims are extensive enough that it may merit a criminal consideration.

I think that it is interesting that we are talking about when a matter that has been investigated and could be civil ends up being criminal and where you draw that line because it has been my experience that very often what we see could clearly be charged as criminal. And we are often making a decision about whether or not we are going to expend, use the resources that we have, as precious as they are to pursue the criminal case. All of us have limited resources and

tried upon ways. We are going to extend those and use those intelligently and I would say just as often we are confident that what we are seeing does meet all the standards of some criminal behavior. And sometimes for the sake of the resources at your office you are making some determination that it is easier. And sometimes you can achieve your level of investor protection by ensuring that someone is out in the industry and that has done it in a public way. If you can get restitution for the victims, sometimes that is a consideration that is a part of the mix as well.

And so I can tell you that from our office's standpoint we find that it greatly beneficial to be able to have the same people who have educated themselves very often on some complex schemes or matters and get to know the players or the people or the firms with the conduct involved to be the same individuals who are then weighing in. There is obviously a way to get a whole new team up to speed. I think there is also a greater continuity of your policy objective of the institution, the same institution and so if there are a series of fraud activities that you were seeing from you are trending that need greater attention, you can give those priorities sometimes. I certainly can't speak for federal agencies but they all have the same overall mission trying to protect the public. But sometimes those may need to be squared where there is obviously the advantage that we might have from the opportunity to have the same people who have decided on that mission directive upfront for people who are making the decision. And so it's helpful. We can also be brutally honest with ourselves about the level or extent of evidence which you have, whether or not this is the appropriate case to play your resources or keep your powder dry.

**LISA FAIRFAX:** Thank you, it sounds like the dividing line, the open terms of appropriateness and other considerations is legal and practical outline which you guys are talking about. One of the things you guys all touched on is sometimes when you have these parallel enforcement actions going on, they raise particular challenges. I think they raise particular challenges for the enforcer as well as for the particular challenges I think for those who are representing people or corporation or entities target two actions going on at the same time. So I wonder if we could talk a little bit about that. I will start with Susan about those particular types of challenges.

**SUSAN MERRILL:** Well, the Department of Justice's appearance in the investigation undeniably complicates representation issues. Even more complicated sometimes though is when you don't know whether the Justice Department is involved or not involved. And I think in today's current climate you have to assume that if you have a high profile securities investigation going on, that the Department of Justice, if they haven't surfaced may very well be in the background. But assuming they have surfaced there are some trade-offs that I think especially if you are representing an individual witness, you have to analyze carefully.

For example if the Department of Justice has decided that they are going to be the primary interviewer of witnesses and doing that in a conference room with the SEC present and maybe people from other regulators present, FBI agents taking notes, that sort of thing, it may serve your client well to go in and appear voluntarily in that setting. Whereas if you were simply in a case that was being investigated by the SEC you may take a more defensive approach and wait for formal testimony. But there can be opportunities as well because it's possible that in this investigation and by your cooperation your client may become… benefit to the Department of Justice in other prosecution that it is pursuing of people further up the chain for example. And then your cooperation may have the benefit of having justice persuade the SEC that they shouldn't be bringing a civil case against your client although possibly they could because of the credibility issues that that will present if Department of Justice wanted to call your witness, your client as a witness in the prosecution of another target. So it certainly does present challenges. I think it presents challenges not only for the bar but also for the SEC and Justice. And George

can talk about that more directly.

But there have been quite a number of cases lately where the SEC's involvement in a matter has tripped up in one way or the other the federal prosecution that we just saw the reversal, squawk box cases because of raiding material that was in the hands of the SEC, that was not turned over…

**GEORGE CANELLOS:** In the hands of the Justice Department. And then provided to the Justice Department.

**SUSAN MERRILL:** It was in the hands of the SEC. And then provided to the Justice Department. And in fact the SEC person who was involved in the case had pointed out to Justice I think that you should look at these transcripts for Brady and then they were not turned over by Justice. So that was the basis for reversal.

**MARC MINOR:** So provided and pointed out by the SEC.

**SUSAN MERRILL:** Provided and pointed out. It does complicate things because there are issues about whether justice is obligated to be reviewing attorney work product of the SEC when it's doing its Brady Review. So it presents challenges on both sides and those are things that complicate but also can be an opportunity for your client.

**LISA FAIRFAX:** George, you just wanted to elaborate a little more about some of the challenges from the SEC side when there is an ongoing parallel DoJ investigation?

**GEORGE CANELLOS:** Sure, provided to and pointed out. I mean I think generally our investigations usually benefit from the involvement of the Justice Department. I think the Justice Department because it has even more potent tools than we have, has the ability to secure the cooperation of witnesses and candor to a greater extent than we do. And that generally benefits both of us.

I also think when you look at relationships among regulators and prosecutors, the relationship between the SEC and the criminal authorities within the Department of Justice really has always been outstanding. It's very symbiotic. We do different things in the sense that we are not competing with one another in any way, shape or form. They have exclusive jurisdiction to bring criminal cases, we can't. We have exclusive jurisdiction to bring civil cases, they can't.

There are a lot of practical complications. I mean I think it is a good thing for an investigation when the criminal authorities are involved but there are a lot of complications. You named some them, Susan. But the very existence of a parallel civil case against an individual who is also criminally charged can be a complicating element for a criminal case, especially if the judges involved in the cases do not stay, entirely stay the civil case in deference to the criminal case because the rules of discovery are a) broader for civil cases, and b) involved in pre-trial depositions, which just are not present in criminal cases. So that is certainly a complicating factor. Even when you get what you ask for, which is usually a stay of the civil case, that can have a lot of issues for us as well. And there are a lot of cases, SEC cases that are stayed in deference to a criminal case and they get dusted off five years later for prosecution, civil prosecution and obviously the passage of that much time with a turnover of staff, stillness of evidence, fading witness recollections is never good for someone who bears the burden of proof. So that can be a complicating element but sometimes that is a price you are very willing to pay when you are able to bring people who are engaged in very serious misconduct to justice

criminally.

There is also the question of whether to file it all and redundancy of remedies which we have been giving a lot of thought to if you go back to when I was first started criminally prosecuting in the mid-'90s, early to mid-'90s, there were not a lot of monetary remedies that were available to criminal authorities. I think it was 1996 that Congress required mandatory restitution in every criminal case. And suddenly that meant that as an incident to the criminal case, a judge presiding in the criminal case could also order the defendant, a restitution to victims. Before that time someone could go to prison, someone could pay a fine but not restitution and the SEC would be desperately needed to provide that component of restitution by means of disgorging the ill-gotten gains and other remedies available to us. There has been generally an expansion of the authority that the criminal prosecutors have to bring monetary claims which make in some cases the need for us to have a parallel civil case a little less pressing than it was a couple of decades ago.

**LISA FAIRFAX:** Marc, I would like to ask you a slightly different question which is, what are the challenges associated with having a kind of parallel state, if you will, investigation as these federal investigations are going on sometimes both criminal and civil or maybe the benefits of stepping in from the stateside?

**MARC MINOR:** Well, when the consideration is within our office obviously you can make election and that makes it very easy where we are investigating conducts along with other agencies whether they are federal or state they can be complicating. You know sometimes it is, we are perfectly willing where we know that there are other enquiries out there. Sometimes we are perfectly willing to collect our information or hear from a person at the same time at another agency, sometimes the subject of our very welcoming invitation, prefer not to take us up on that and there are lots of consequences I have had. I recognize us in the room hearing the answers along with some other agency. In coordinating with other states really depends from state to state, every state securities' administrator does not have criminal authority. Only five states in the country have their securities administration authority in an attorney-general's office. There is another handful who have criminal authority within that agency and there are as many other different configurations as there are states whether it is the secretary of state or the treasurer has that authority. But we have very good working relationships with them.

I think we have some of the same considerations as anyone else when we know that there are other institutions with criminal authority may also be conducting an enquiry. And one of our principal considerations is anyone looking at this are the three institutions all with similar authority looking at it or are you looking at that activity but from a different lens? Sometimes a consideration that we make is if we are conducting an investigation to see whether or not the activity and culpability even meets a criminal threshold. I mean for that purpose essentially everything is a civil until it is not. And you find that the activity that you are finding is reaching some threshold that makes it more serious. And then at that point there may be other, in New York it is very often on Eastern Districts, Southern Districts, Justice or increasingly as Susan mentioned, other settlement authorities who are interested in that conduct and you have to find your way. And then amongst those regulators they have a panoply of tools at their disposal and sometimes if we are looking to make sure that the conducted activity is addressed, we will defer or make a decision that the best opportunity to readdress for us to move forward. And every once in a while start all those notwithstanding. Our office has to make an independent decision that we are going to move forward even though there are other institutions with criminal authority who are moving forward.

**LISA FAIRFAX:** Certainly one of the things that certainly happens with regard to criminal enforcement efforts, civil efforts, sometimes you have the phenomenon of both individuals and entities target it by investigations. I want to talk a little bit about what kind of challenges those folks particularly from a representation point of view will also from an enforcement point of view. So, Susan, talk a bit about that.

**SUSAN MERRILL:** Well, if you truly have a corporation and individuals who have been identified as targets, it's nearly impossible if not downright unethical for those entities to have the same lawyer. And so right away you have an issue of representation that has to be addressed but the problem is really when the corporation and the individuals are subjects of the investigation and the Department of Justice does tell you and has these labels of target subject and witness although the subject category seems to be quite broad and the witness category very small. So when you are told that the corporation is a subject or a particular individual is a subject you do have to analyze quite carefully whether joint representation is appropriate. And I think in SEC cases and the SEC does not use those, well, you are kind of… you officially don't but you try to signal it but… Well, good, I am going to start asking that question on the record more often.

But with the SEC, I think it is more common to see the corporation and the individuals have a joint representation at least to a point. And particularly when it is very clear that the individual is acting with the corporation's blessing in doing what they were doing. But when you get into the criminal sphere, the stakes are higher obviously and it is not impossible to represent an individual and a corporation when the words subjects are being thrown around. But there are some issues that have to be taken into consideration. For example, you may think you know everything about the individual in relationship to the conduct that is under investigation. And with the facts that you know you may think there is no possible conflict that could arise. But you don't know what you don't know. And the risk that something comes up unanticipated, although the risk maybe very small, the magnitude of the harm that can come from that is quite real. And so in some cases it's become common to have at least shadow counsel for an individual, an individual who you believe has absolutely no conflict whatsoever with the company. But at least it gives that person someone to talk to.

I have also seen instances where the Department of Justice has insisted that individuals be separately represented in the investigation. And in that case you really have to go along with their suggestion. I don't think you have much of an option there. And then you get into issues about how you are communicating, coordinating between the corporation and the individual, to say nothing of the cost involved of hiring a full legal team for each particular person who maybe within the subject of the investigation. It does become a bit of a 3D chess match but it can be handled, I think. You don't want to find yourself in a position at the end of the day where the focus is on lawyer's decision about that joint representation. So in a closed call I think the counsel should always view as the safest road to go separate.

**LISA FAIRFAX:** Depending on who you are, some people think it is more appropriate for your focus to be your corporation than for the individuals who have been in that corporation. Do you have a kind of view on that in terms of who, what persons, entities should leave a target witness subject?

**GEORGE CANELLOS:** I think we need to step back. There is a lot of levels at which you can analyze that issue. You need to begin with the recognition that there are some statutory duties that rest with a particular person or entity. And don't rest with anyone else except on some theory of secondary liability. So just to take an example, every public company as probably

every single person here knows has the affirmative obligation to maintain reasonable system of accounting controls and to maintain accurate books and records. Those obligations rest on the company and it is strict liability.

Now there are various provisions that could make some individual secondarily liable by just analyzing the question whether a company is liable is fundamentally different from analyzing the question of whether an individual is liable. So there are significant statutory differences. We also need to recognize that you know corporations act through individuals and generally speaking when you are talking about fraud, especially scienter-based fraud you know one would be hard pressed to think you have adequate deterrence by bringing a case against the company when there is a culpable individual actor out there. Obviously you want to reach the individual actor who is engaging in the misconduct and I think everyone recognizes that nothing sends a message more to people than the fear of individual liability as distinct from liability for the company that they happen to work for. So there is bringing cases against individuals especially in the context of fraud is an unbelievably important component of what we do.

I don't think that people should go assume that you need to have an individual in every case against a company. I mentioned instances where companies have statutory obligations that are fundamentally different from the individuals who are the actors within the company. But I think there are also cases involving negligent misconduct and we have probably been charging more frequently than we did in the past. Section 17a2 and 3 of the 1933 Act, the provisions of the Investment Advisor's Act, anti-fraud provisions that are negligence based. And in a negligence based case, I do think, A, that there are some cases where you look at negligence and you ask yourself the question, you know how did this happen and who is at fault? And the answer is there is probably a lot more collective institutional fault than fault that should be assigned to any particular individual. He sort of fell through the cracks because we didn't have the systems. And Johnny missed it and Johnny thought Steve was looking at it but basically there was a fundamental flaw, a corporate flaw that you could call negligence, that is more easily assigned to a collective entity than the individual. And second even when you have the negligent acts being perpetrated let us say by one individual acting without association with anyone else. I think there is a practical difference in the way we do and can and sometimes do analyze those cases.

I think it is just a reality that when you are acting as a regulator and you want to regulate the conduct of those within your jurisdiction bringing an action against a company and ascribing to that company some disgorgement of some ill-gotten gains and some appropriate and temporary penalty sends a message, gets the company on the straight and narrow, enhances their focus on compliance with the law and allows them to continue in business more compliant with the law than ever. Sometimes charging an individual is a bit of a binary decision. You charge and that is the end of their career or you don't charge. And so I think that our remedies and our ability to charge corporations do allow for a little more calibration than they do in the context of charging individuals.

So that is sort of a very long winded and twisting and turning answers to your question but at least it spots some of the issues that are very thorny ones that we grapple with every day.

**SUSAN MERRILL:** I am glad to hear you say that not every case against a corporation requires an individual being charged. I am more happy that this is being recorded. But I do want to mention that in the cases particularly financial crisis cases involving the sales of CDOs and mortgage backed products where settlements have been achieved on negligence grounds as you said Section 17 of the '33 Act. The SEC has still gone on to charge individuals who were

involved in those sales.

**GEORGE CANELLOS:** I hope my answer didn't imply we wouldn't. I am just saying it's not an automatic thing, its evaluation of the conduct of an individual.

**SUSAN MERRILL:** Right. But if the corporation acting through that individual is guilty of negligence than it is hard to understand why the individual who did the act is culpable to something more than that negligence.

**GEORGE CANELLOS:** You are spotting instances in which the companies are charged with negligence but…

**LISA FAIRFAX:** Correct.

**GEORGE CANELLOS:** ..the individuals charged with fraud?

**LISA FAIRFAX:** Yes.

**GEORGE CANELLOS:** I am not sure there are so many such examples. And you know I don't want to get too much into the weeds on this. But I think there are a lot of people who mistake fraud cases for negligence cases and I am just kind of going to give you an example. The Martin Act which Mark can talk about in great detail. I think it is fair to assume does not require scienter. And yet that means it doesn't require scienter but it certainly triggers it when you have scienter. So you engage in intentional fraud you violate the Martin Act, you engage negligent misrepresentation, you violate the Martin Act and it is just one monochromatic statute. And that means many times, many times serious frauds are charged under the Martin Act which doesn't require scienter and just because the statutory provision at the end of the complaint says wherefore you violated the Martin Act doesn't require scienter. It doesn't mean that you are not being charged with something that involves scienter. So I think there are frankly instances where I don't care. If I have a statute that can be violated through negligent conduct or scienter-based conduct and I can get the revenue that is in the interest of the public though the same penalty, the same disgorgement of ill-gotten gains, the same industry bars and suspensions. I can invoke that statute for fraudulent conduct. So I think one really needs to look, we should really be focusing on the nature of the allegations which reflect our view, the SEC's view of what conduct you actually perpetrated as a defendant, not necessarily which charge because the wherefore could include any number of statutory provisions triggered by your misconduct. Maybe that is a little bit of an explanation for maybe something that you are referring to but I am on my hobby horse.

**MARC MINOR:** You know I would even go a little bit further. But it is my view that there is always an individual who is ultimately responsible either under the requirements of the law or the rules or regulations policies and procedures of the institution or by fact. I think that the issue is either the easier one to resolve where the individual is a lone actor or an individual within an institution. More often than not though there is a system, a pattern, a practice within which an individual operates. I often find these investigations that there is an institutional kind of a creep where there is an activity which maybe a bit outside the norm. it maybe well known within the institution, those individuals may then end up going to another bank or institution and in order to be competitive they have to find a way to make sure they are operating in the same sort of sphere. Then you look up and the entire industry is engaging in this conduct or behavior. So it has become the norm but from a regular standpoint has nonetheless gone on the other side of the law. And so you might look and see there is a whole institution that is I will say tolerating an

activity that we would expect seeing your level management of the firm to be asking the difficult questions about. So those instances we are always asking who is ultimately responsible for the themes that we have some serious concerns about. That doesn't always mean that the person that you identify is then going to be charged with criminal and certainly very often in order to adequately examine those and answer those questions, you need to know and understand whether or not the written policies and procedures surrounding the thing, what is done when the red flag deliberating to that. Whether or not the issue is alleviated. And whether or not there are reasonable steps along the way are responded to by the persons who are ultimately responsible for that.

Any thorough investigation you have to answer who is responsible for the thing that you believe is wrongful and then knowing how they got from the activity to your investigation, therein lies the facts by which you can make a decision whether or not there should be individual culpability.

**LISA FAIRFAX:** Thank you. I want to turn the focus just a little bit and actually talk a little bit about particular types of cases one of which is insider trading case. We seem to have seen a number of those and my question is why and if there is something you need about the current environment or something else going on there that is leading into at least a perception that there is kind of more insider trading cases going on. Maybe there is the ease of kind of targeting those types of cases, Susan and George?

**GEORGE CANELLOS:** Look, I don't have any kind of scientific perspective. I have some personal perceptions of the matter and I will share those but anyone's guess is maybe as good as mine. Just I think insider trading is the incidence, if you look at the various types of violations that we prosecute civilly and criminally, I think insider trading, the disparity between the amount of insider trading and the number of prosecutions and enforcement actions arising from insider trading probably is as grey as in any area. I think if you go back and look at the last 20/30 years there are many, many, many instances of insider trading that have gone undetected and unprosecuted. So to some extent I think what you are seeing is better enforcement. To some extent I also think that if there is reason to suspect that there is a higher incidence. And the reason I suspect is, there is somewhat higher incidences that I think over the last two decades you have had the development of very sophisticated proprietary trading in the form of hedge funds. I mean there are hedge funds obviously for about 50 years. But there has been an explosive growth in hedge funds. And absolutely nothing wrong with hedge funds but hedge fund managers tend to be very sophisticated, very connected to issuers, very connected to sell side Wall Street. So there are a lot of personal relationships, they are very directed towards earning incremental gains. They are very sophisticated investors. They use leverage which can mean that information in my hands is going to make me jump change and it is not even worth my effort to use it. But in the hands of a very skilled investor who is highly leveraged it could be used very much more effectively. So there is relationships and there is sophistication. Also you know we have had great increases in the liquidity of options markets which is obviously a way to exploit material non-public information, as well as great decrease in transaction costs for executing trades both in the options markets and the equity markets.

So there is more opportunity I think than ever to take relatively, you know information such as advance information about whether a company is going to miss its consensus analyst's estimates of earnings by 3 cents per share and turn that information to explosive profit. I don't think you could as easily turn that information into explosive profit 30 years ago than you could now. Those factors are reasons to suppose there maybe actually higher incidents of insider trading and not just higher incidence of detection and enforcement.

**LISA FAIRFAX:** Thank you. Well, we will have to leave it there for now. I want to thank my panel today, Susan, George and Marc for sharing your insights and experiences. I hope everyone found it to be an informative discussion about criminal enforcement and securities laws. Today's discussion will be a valuable addition to the body of knowledge in the Bingham Presents series. An audio of today's program will soon be available in the virtual museum and archive at www.sechistorical.org. An edited transcript will be added later on. The Bingham website will also have a transcript of today's discussion. On behalf of the SEC Historical Society, I would like to thank Bingham McCutchen LLP for their sponsorship and hospitality in making today's program possible. Thanks also to our audiences who have gathered here in Bingham's office in New York and joining us online. I hope everyone has a good evening.