

Emboldened SEC Spells Double Trouble For Defense Bar

By **Phillip Bantz**

Law360 (June 7, 2024, 2:35 PM EDT) -- The U.S. Securities and Exchange Commission's enforcement division has taken an increasingly aggressive stance in recent years thanks in part to an influx of federal prosecutors joining the agency and court decisions that have gradually become more permissive on parallel civil and criminal investigations, defense lawyers say.

Rather than being rooted in a major policy shift, the development of a more forceful SEC has happened organically over time, primarily through the "cross-pollination" of the SEC and U.S. Department of Justice, according to Brad Bondi, global co-chair of the investigations and white-collar group at Paul Hastings LLP.

Bondi formerly served as a member of the SEC's executive staff and as counsel to two SEC commissioners for enforcement actions and regulatory rulemaking from 2008 to 2010.

He told Law360 that the seeds of change were sown around 2009, when Rob Khuzami, then a former federal prosecutor for the U.S. Attorney's Office for the Southern District of New York in Manhattan — which prosecutes the lion's share of the country's criminal securities cases — was appointed as the SEC's enforcement director.

Further examples of cross-pollination include George Canellos, an ex-federal prosecutor in Manhattan, who joined the SEC in 2009 as director of the New York regional office. Khuzami's deputy director at the SEC, Lorin Reisner, crossed over to the DOJ in 2012 to serve as chief of the Southern District's criminal division.

Khuzami exited the SEC in 2018 and returned to the Southern District as a deputy U.S. attorney. And in 2022, the SEC tapped former Southern District criminal prosecutor Antonia Apps to serve as director of the agency's New York office.

Khuzami, Canellos and Reisner have left government practice, but the effects of the crossover between the DOJ and SEC remain, according to Bondi.

"Now, because people know each other at both agencies and the agencies are so incredibly close, they're calling up their friends at the U.S. Attorney's Office in the Southern District or at the SEC," Bondi said. "Hardly ever am I dealing with the securities unit at the U.S. Attorney's Office in New York that I don't quickly get a call from the SEC. They're always there."

The result, Bondi asserted, is that more securities cases that would have only resulted in civil enforcement actions from the SEC in the past are now being prosecuted criminally.

As an example, he compared the SEC-only case against Salix Pharmaceuticals' former chief financial officer Adam Derbyshire — who paid \$1 million in 2018 to settle civil claims that he repeatedly lied to investors — with the more recent insider trading case of British billionaire and octogenarian Joe Lewis.

Lewis, who was prosecuted by the SEC and DOJ for sharing confidential stock tips with his girlfriend, personal pilot and employees, pled guilty to criminal insider trading charges earlier this year. He was sentenced in April to three years' probation and fined \$5 million.

Criminal "referral should be for rare cases, not as a matter of course, as it's become," Terence Healy, chair of Hughes Hubbard & Reed LLP's securities enforcement group, told Law360. He formerly served as senior assistant chief litigation counsel at the SEC and as a federal prosecutor in Washington, D.C.

"The big question now is whether every violation of federal securities laws is criminal," Bondi added.

According to the SEC's enforcement manual, "cooperating with criminal authorities is an important component of the SEC's enforcement mission," and staff are encouraged to "work cooperatively with criminal authorities, to share information and to coordinate their investigations with parallel criminal investigations when appropriate."

A representative for the DOJ declined to comment.

Talk or Take the Fifth

One particularly hard-nosed tactic on the civil side of the enforcement equation that is raising alarms among members of the defense bar is what experts describe as the SEC's apparent indifference to the constitutional dilemma facing targets of parallel civil and criminal securities enforcement proceedings.

They say the SEC has in recent years adopted what amounts to a take-it-or-leave-it approach in pushing targets to either talk with investigators — and potentially incriminate themselves in the criminal case — or assert their Fifth Amendment right against self-incrimination. The latter option allows the SEC to draw an adverse or negative inference from the target's silence.

"If you're pleading the Fifth, there's not much else you can do, and you're very likely to face penalties from the SEC in that scenario," Jennifer Beidel, a white-collar partner at Dykema Gossett PLLC, told Law360. "But a lot of lawyers are still telling their clients, 'Look, whatever the SEC is going to give you, you have to face it, because the criminal risk is so much more serious.'"

Having a target take the Fifth during the investigative stage of an SEC proceeding "certainly gives [SEC attorneys] leverage with respect to the commission authorizing a lawsuit later," noted Alex Bourelly of Bourelly George & Brodey PLLC, a former senior counsel for the SEC and ex-federal prosecutor in Washington, D.C.

After the SEC has filed suit, a defendant who declined to talk during the investigative phase can still waive their Fifth Amendment rights in the civil proceeding and testify in court, "but absolutely to the detriment of their ongoing criminal case," Bourelly noted.

The talk-or-take-the-Fifth dilemma isn't new in the context of parallel SEC and DOJ enforcement actions, but the SEC has been getting more difficult to negotiate with over the past four or five years when it comes to trying to buy time for clients to resolve their criminal cases first, according to Beidel.

"The SEC seemed more reasonably conscious of the criminal schedule in the past," she said. "Now, what I've been seeing — and I've talked with others who are seeing similar things — is that the SEC, even before they finish their factual findings, they want to put the target of a criminal investigation into an SEC deposition to give a recorded statement while the criminal case is pending."

For instance, Beidel said the SEC used to be more willing to accept information from targets or their attorneys under proffer agreements, which prevent the statements from being used in criminal prosecutions. But that's no longer the case.

"The last three or four most recent times I've tried that, the SEC has not been receptive to it anymore," she said.

Other previously successful strategies, such as asking the SEC to hold off on issuing a letter, known as a Wells Notice, notifying targets of the charges they might face and giving them the opportunity to respond with a written statement, are also falling flat, according to Beidel. The tactic had sometimes given targets more breathing room to deal with parallel criminal matters.

"I've tried, and my colleagues have tried all the possible ways to say, 'Are you sure you have to do this now?'" Beidel said. "And it does not seem to be moving them. I don't think we have any other abilities that we're not using to try to change this."

The SEC's more assertive stance might stem, at least in part, from the Dodd-Frank Act's requirement that the agency bring a case 180 days after it issues a Wells Notice, said Matthew Allen, a principal at Miller Canfield Paddock & Stone PLC. He noted "at least one federal court has held this is merely an internal SEC requirement and not a jurisdictional bar, but it's nonetheless a congressional directive to the SEC."

The SEC recently accelerated the deposition date for one of Beidel's clients facing a parallel DOJ probe, she said. The client decided to plead the Fifth on potential criminal issues that the DOJ seemed to be investigating but testify to the SEC about what the client thought was a separate part of the civil matter.

"What happened from that deposition is there's now likely to be spillover from the information that went to the SEC, then got to the DOJ," Beidel said. "So the DOJ is, after the fact, expanding its investigation to include this other topic area that the client testified about before the SEC."

She added: "This client testified on the subject matter of the SEC investigation because the alternative was getting an adverse inference, and this was the only possible way to avoid that outcome."

A spokesperson for the SEC told Law360 in a statement that the agency's "investigations are driven by the agency's own independent civil investigative purposes, and SEC staff make their own independent decisions, such as what investigative testimony to take and when, based on the facts and circumstances of each matter."

SEC staff "typically will require testimony by or a declaration from the witness to assert the witness's Fifth Amendment privilege. Staff typically will not accept a letter from counsel as an alternative to

testimony or a declaration," according to the SEC's enforcement manual.

The SEC's "reasons for requiring a witness to appear in person to assert the Fifth Amendment privilege include, but are not limited to, obtaining a clear and specific privilege assertion on the record, allowing the staff to probe the scope of the privilege assertion, and allowing the staff to determine whether there are grounds to challenge the assertion," the manual states.

'Frightening for Defendants'

When Bourelly was an SEC lawyer from 1995 to 1998, he said he and his colleagues routinely sought to get the DOJ involved in cases when they felt the target had committed acts so egregious that a civil penalty wasn't sufficient punishment.

"When you're at the SEC, you don't have criminal authority. You can only get money back from these people," he said. "But nothing trains the mind like losing your liberty. So you try to get the criminal authorities interested in your case."

The DOJ began to get particularly interested in SEC cases in the wake of the 2008 financial crisis, according to Fred Block, a partner at Morgan Lewis & Bockius LLP. He worked for more than 15 years at the SEC as a trial attorney and supervisory trial counsel.

"There was a critique that not enough people went down," Block said. "Prosecutors likely felt some of that critique and became more interested in demonstrating to the public that being a successful businessman didn't mean you were immune from criminal prosecution."

Criminal cases must be proven beyond a reasonable doubt, while civil cases have a lower standard of proof typically based on a preponderance of the evidence. But in some cases, it can be easier for a prosecutor to establish the elements of wire fraud than to establish securities law violations based on the same set of facts, because the wire fraud statute is "so broad and amorphous," according to Bondi.

"What you worry about are the tough cases for the government that might not have been brought even civilly by the SEC," he said. "But because of these tools in the prosecutor's arsenal, they might get brought criminally, which is frightening for defendants."

Joint Probes, Discovery Woes

Increased collaboration between the SEC and DOJ has also raised concerns about information-sharing and behind-the-scenes collusion between the two agencies.

For instance, Beidel represents another client in a matter in which the DOJ seized materials with a search warrant as part of a criminal investigation and then shared what it collected with the SEC for a civil probe. Charges have not been filed in the case, and both agencies are refusing to share the seized materials with Beidel's client, she told Law360.

"We're trying to negotiate through this, but for now, the DOJ won't share these documents, and even if the SEC was willing to give us copies of the documents, they really can't because of this separate criminal issue," she said.

When there's "clear coordination" between the SEC and DOJ where, for instance, one agency is

collaborating with the other on investigative tactics or the timing of filing charges, the defendant should be entitled to discovery from both agencies, according to Bondi.

But he said courts are rejecting the argument out of hand.

That's what happened when Bondi filed a motion in 2022 to compel discovery related to the SEC and DOJ securities fraud investigation of his client Trevor Milton, former executive chairman and CEO of electric-truck maker Nikola Corp.

Nikola settled with the SEC, and part of the deal required the company to provide the agency with all documents and other information related to an ongoing securities and wire fraud investigation that involved Milton.

The SEC and federal prosecutors in New York's Southern District jointly interviewed dozens of witnesses in the case, had joint meetings with defense counsel, filed parallel actions against Milton the same morning and later held a joint press conference, according to Bondi's motion.

But the government contended the SEC was not part of the prosecution team, and the court agreed. Milton was ultimately convicted in the criminal case and sentenced in December to four years in prison. He has denied wrongdoing and is appealing his conviction.

Perhaps the most recent significant case to address the issue of cooperation between the SEC and DOJ is that of Kenneth Stringer, former CEO of Oregon-based thermal imaging technology firm FLIR Systems Inc.

A federal judge in Oregon ruled in 2006 that the government violated Stringer's rights against self-incrimination because the SEC worked behind the scenes with the DOJ to build a criminal case against the former executive without telling him he was the target of a criminal investigation.

But the Ninth Circuit reversed the trial court's ruling in 2008, finding "there was no deceit; rather, at most, there was a government decision not to conduct the criminal investigation openly, a decision we hold the government was free to make."

"After the Stringer case, which made the law on joint and parallel investigations better for the prosecution, you have the cross-pollination between the two agencies," Bondi said. "It has culminated now where the two agencies are working together more closely than ever."

--Additional reporting by Dorothy Atkins, Pete Brush, Rachel Scharf and Daniel Siegal. Editing by Philip Shea.