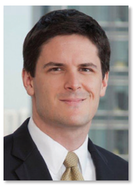
Securities Litigation and Government Enforcement Trends

WINTER 2016

In This Issue

VedderPrice

U.S. Supreme Court Upholds Insider Trading Conviction Based on Tips from Family Member



Joshua A. Dunn
Associate
+1 (212) 407 7791
jdunn@vedderprice.com

On December 6, 2016, the U.S. Supreme Court issued its first decision addressing the scope of insider trading liability in nearly 20 years. The high court's heavily-anticipated decision in *Salman v. United States of America*[1] arose from petitioner Bassam Yacoub Salman's (Salman) challenge of his 2014 conviction for insider trading on tips from his future brother-in-law on the grounds that the prosecutors had failed to present sufficient evidence under the standard used by the U.S. Court of Appeals for the Second Circuit (Second Circuit) in *United States v. Newman*,[2] which was widely considered to have raised the bar for insider trading prosecutions. While the Supreme Court upheld Salman's insider trading conviction in an 8-opinion authored by Justice Samuel Alito based on the existence of a family relationship, the Supreme Court's narrow holding continues to leave open questions regarding what constitutes a sufficient "personal benefit" involving other types of relationships or more remote tippee situations.

The government had charged Salman with insider trading and conspiracy arising out of an alleged scheme to trade on inside information originating with his future brother-in-law, Maher Kara, a former analyst in Citibank's healthcare investment banking group, and Maher's brother, Michael Kara. At trial, the government presented evidence that Salman had traded using inside information he had received from Michael Kara, but which he knew had been originally disclosed by his future brother-in-law, Maher Kara. The government also presented evidence at trial that Salman was aware of the Kara brothers' "close fraternal relationship."[3] A jury found Salman guilty on all counts, and Salman appealed to the U.S. Court of Appeals for the Ninth Circuit (Ninth Circuit).

During the pendency of Salman's Ninth Circuit appeal, the Second Circuit issued its decision in *Newman*, which vacated the convictions of two so-called "downstream" or remote tippees on the grounds that the government had failed to present sufficient evidence that: (i) the tippees knew the information received had been disclosed in exchange for a "personal benefit" and in breach of a fiduciary duty and (ii) the personal benefit comprised something of a "pecuniary or similarly valuable nature."[4] At Salman's request, the Ninth Circuit panel allowed the parties to submit supplemental briefs to address *Newman*. Nonetheless, on July 6, 2015, the Ninth Circuit affirmed Salman's conviction, rejecting *Newman* and expressly relying on the Supreme Court's 1983 decision in *Dirks v. SEC*.[5]

---

1 *Salman v. United States*, 580 U.S. __ (2016).

2 773 F.3d 438 (2d Cir. 2014), *cert. denied*, 136 S. Ct. 242 (2015).

3 *U.S. v. Salman*, 792 F.3d 1087, 1090 (9th Cir. 2015).

4 *Newman*, 773 F.3d at 455.

5 463 U.S. 646 (1983).

The resulting circuit split—and Salman's subsequent petition—presented the Supreme Court with the opportunity to address whether the "personal benefit" to the insider, which the Supreme Court deemed necessary to establish insider trading under *Dirks*, requires proof of "an exchange that is objective, consequential, and represents at least a potential gain of a pecuniary or similarly valuable nature," as the Second Circuit held in *Newman*, or whether it is enough that the insider and the tippee shared a close family relationship, as the Ninth Circuit held in affirming Salman's conviction.[6]

In its unanimous decision, the Supreme Court affirmed the Ninth Circuit's decision upholding Salman's conviction. The Supreme Court characterized the issue presented before it as a narrow one that was "easily resolve[d]" by the long-standing rule espoused in *Dirks* that an insider effectively receives the required personal benefit when disclosure of the inside information is made as a gift to a "trading relative or friend."[7] The Supreme Court explained that, under these circumstances, "the tipper benefits personally because giving a gift of trading information is the same thing as trading by the tipper followed by a gift of the proceeds."[8] Because *Dirks* clearly prohibits the latter type of gift, the Supreme Court reasoned that the insider in *Salman*, Maher Kara, should be precluded from "effectively achiev[ing] the same result" by disclosing the information to his brother and to Salman and by then allowing them to trade on it.[9] According to the Supreme Court, Maher Kara's disclosure of confidential information was a breach of his duty of trust and confidence to his employer and its clients—a duty Salman both acquired and breached by trading on the information despite having knowledge that it was improperly disclosed.[10]

The *Salman* case was viewed by many as an opportunity for the Supreme Court to elaborate on the elements of an insider trading violation, particularly in the context of a tipper and downstream tippee, and to clarify an area of the law that had only become more unsettled in the wake of *Newman*. In reality, however, the Supreme Court construed the issue presented very narrowly and expressly limited its holding to the context of a gift of confidential information to a trading relative or friend, drawing on *Dirks* and rejecting *Newman*'s additional requirement of proof of pecuniary gain to the tipper in this specific context. Nonetheless, the *Salman* decision may embolden prosecutors and regulators to investigate and prosecute similar cases, including those in which insiders tip downstream and/or to family member tippees in exchange for purely reputational or other non-pecuniary personal benefits.

6 *Salman v. United States,* 136 S. Ct. 899 (2016).

7 *Salman*, 580 U.S.___, Op. at 10. Notably, the *Salman* decision expressly overturned *Newman* only to the extent its holding can be read to require the tipper to receive "something of a 'pecuniary or similarly valuable nature' in exchange for a gift to family or friends." *Newman* appears to remain good law on other points, including the requirement that a tippee have actual knowledge that the insider disclosed confidential information in exchange for a personal benefit.

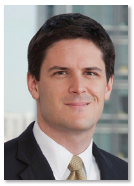
8 *Id.*

9 *Id* at 9.

10 *Id.* at 10.

SEC Placing Renewed Emphasis on Whistleblower Protections

Elizabeth N. Hall
Shareholder
+1 (312) 609 7795
ehall@vedderprice.com



Joshua A. Dunn
Associate
+1 (212) 407 7791
jdunn@vedderprice.com

Recent enforcement actions brought by the U.S. Securities and Exchange Commission (SEC) underscore the SEC's renewed commitment to protecting and encouraging whistleblowers, particularly in connection with what the SEC views as employer conduct that may impede or deter employee whistleblowers from reporting possible violations of federal securities laws.

In August 2016, the SEC entered into settlements with two companies for allegedly violating SEC Rule 21F-17 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Rule 21F-17), which provides that "[n]o person may take any action to impede an individual from communicating directly with the Commission staff about a potential securities law violation, including enforcing, or threatening to enforce, a confidentiality agreement."[1]

First, on August 10, 2016, the SEC entered into a settlement with BlueLinx Holdings, Inc. (BlueLinx) for language in its standard severance agreements, which generally prohibited employees from divulging confidential information without written permission of or notice to BlueLinx and provided that, while employees could file a claim with the SEC (and other agencies), the employee waived the right to monetary recovery in relation to such a claim.[2] The SEC found that such language violated Rule 21F-17 by raising "impediments" to participation in the SEC whistleblower program and "removed the critically important financial incentives that are intended to encourage persons to communicate" with the SEC about possible securities law violations.[3] Among other things, the SEC's cease-and-desist order imposed a $265,000 civil penalty against BlueLinx and required BlueLinx to (i) contact former employees who signed the severance agreements; (ii) provide those employees with a link to the SEC's cease-and-desist order; and (iii) confirm with those employees that they could provide information to the SEC and accept a whistleblower award from the SEC.[4] Going forward, BlueLinx must also include language in its severance agreements specifying that nothing in those agreements limits the employee's right to receive an award for information provided to a government agency, including the SEC.

Further, on August 16, 2016, Health Net, Inc. (Health Net), in a settlement reached with the SEC, agreed to pay the SEC a $340,000 civil penalty stemming from similar language in its severance agreements which required employees to waive: (i) "the right to file an application for award for original information submitted pursuant to Section 21F of the Securities Exchange Act of 1934;" and (ii) "any right to any individual monetary recovery in any [lawsuit against

---

1 In April 2015, the SEC instituted a first-of-its-kind enforcement action against KBR, Inc. (KBR) for violating Rule 21F-17 based on language contained in KBR's confidentiality agreements with its employees. *See In the Matter of KBR, Inc.*, No. 3-16466 (Apr. 1, 2015).

2 *See In the Matter of BlueLinx Holdings, Inc.*, No. 3-17371 (Aug. 10, 2016).

3 *Id.*

4 *Id.*

the Company] or in any proceeding brought based on any communication by Employee to any federal, state, or local government agency or department."[5] Like BlueLinx, Health Net had amended its agreement language on several occasions to clarify that nothing in the agreement prohibited employees from communicating directly with a government regulator as part of an investigation.[6] However, the SEC found that, because the agreement language prohibited an employee from accepting any individual financial awards for providing information regarding possible securities law violations, it violated Rule 21F-17. Like BlueLinx, Health Net also agreed to contact former employees to inform them that their severance agreements do not prohibit them from obtaining SEC whistleblower awards.[7]

On September 28, 2016, Anheuser-Busch InBev SA/NV (AB InBev) agreed to disgorge more than $2.7 million and to pay a civil money penalty of more than $3 million to settle SEC charges based on violations of the Foreign Corrupt Practices Act (FCPA) and Rule 21F-17(a).[8] There, a subsidiary of AB InBev entered into a confidential release with a former employee who had raised concerns to AB InBev of alleged FCPA violations.[9] The release not only precluded the former employee from disclosing the company's confidential information, including to government regulators, but also required him to pay liquidated damages of $250,000 in the event of a breach.[10] The SEC found that this language, and the employee's related concern regarding the threat of liquidated damages, caused the employee to stop communicating with the SEC, as he had been doing on a voluntary basis prior to executing the confidential release. In addition to paying the civil penalty, AB InBev agreed to make reasonable efforts to notify other former employees that their release agreements do not prohibit them from contacting the SEC about possible violations of the federal securities laws.[11]

Consistent with its focus on whistleblower protections, on September 29, 2016, the SEC brought its first-ever enforcement action based exclusively on alleged retaliation against a whistleblower.[12] In that action, the SEC alleged that International Game Technology (IGT) fired an executive whistleblower because he reported to management and the SEC his suspicions that the company's financial statements might be misstated.[13] As a result, the SEC ordered IGT to pay a $500,000 civil money penalty.[14] The IGT cease-and-desist order is unique in that the SEC did not allege violations of any securities laws other than Section 21(h) of the Exchange Act, signaling the SEC's willingness to pursue stand-alone retaliation actions, as compared to the *Paradigm Capital Management, Inc*. action from 2014, in which the SEC also charged the hedge fund advisory firm with engaging in prohibited principal transactions.[15]

5 *Id.*

6 *See In the Matter of Health Net, Inc.,* No. 3-17396 (Aug. 16, 2016).

7 *Id.*at 4.

8 *In the Matter of Anheuser-Busch InBev SA/NV,* No. 3-17586 (Sept. 28, 2016).

9 *Id.*at 6.

10 *Id.*at 6-7.

11 *Id.*at 12.

12 *In the Matter of International Game Technology,* No. 3-17596 (Sept. 29, 2016).

13 *Id.*at 2.

14 *Id.*at 5.

15 *In the Matter of Paradigm Capital Management, Inc.,* No. 3-15930 (June 16, 2014).

On October 24, 2016, the SEC issued a Risk Alert targeting investment advisers and broker dealers and their compliance with whistleblower rules under Rule 21F-17.[16] In the Risk Alert, the SEC confirmed that the Office of Compliance Inspections and Examinations is reviewing, among other things, "compliance manuals, codes of ethics, employment agreements and severance agreements" to determine whether provisions relating to confidential information and reporting of alleged securities law violations may conflict with Rule 21F-17.[17] Per the Risk Alert, "[r]egistrants are encouraged to consider the issues identified in the Risk Alert" and to evaluate the above referenced documents and others that "may be inconsistent with Rule 21F-17."[18]

The SEC is not alone in its current focus on employer agreements and the implications they have on an employee's ability to freely communicate with governmental agencies. On August 23, 2016, the Occupational Safety and Health Administration (OSHA) issued guidelines for approving settlement agreements between employers and employees in whistleblower cases.[19] In the guidance, OSHA specified that agreements that, among other things, discourage employees from sharing information with the government or filing a complaint with the government or participating in a governmental proceeding will not be approved.[20] OSHA's guidance targets many of the same types of clauses that have garnered the SEC's focus.

Employers, particularly registrants subject to the SEC, should have their agreements (employment, separation, severance, restrictive covenant, non-disclosure and confidentiality agreements, for example), policies, codes and guidelines reviewed by counsel to identify and rectify language that may run afoul of Rule 21F-17. In doing so, companies should keep in mind that other governmental agencies, including the Equal Employment Opportunity Commission, National Labor Relations Board and OSHA have taken positions similar to those espoused by the SEC with respect to agreement and policy provisions that seemingly impinge on certain employee "rights." Employers are cautioned against utilizing a "one size fits all" clause for all documents, as those may not adequately cure or address all issues identified as problematic by the SEC and other governmental agencies. Further, employers, in consultation with counsel, should continue to monitor future developments at the SEC in 2017, particularly in light of any changes to the agency's staff and to its enforcement priorities in light of future appointments to be made by President-Elect Donald Trump.

16 U.S. Sec. & Exch. Comm'n, Office of Compliance Inspections and Examinations, Nat'l Exam Program Risk Alert, Vol. VI, Issue 1, Examining Whistleblower Rule Compliance (2016) (*available at:* https://www.sec.gov/ocie/announcement/ocie-2016-risk-alert-examining-whistleblower-rule-compliance.pdf).

17 *Id.*

18 *Id.*

19 U.S. Dep't of Labor Occupational Safety & Health Admin., New Policy Guidelines for Approving Settlement Agreements in Whistleblower Cases (2016) (*available at:* http://www.whistleblowers.gov/memo/InterimGuidance-DeFactoGagOrderProvisions.pdf).

20 *Id.*

Declinations with Disgorgement: The DOJ's Recent Approach in FCPA Enforcement

Martin McElligott
Associate
+1 (312) 609 7876
mmcelligott@vedderprice.com

On September 29, 2016, the U.S. Department of Justice (DOJ) issued declination letters informing two privately-held Texas companies, HMT, LLC (HMT) and NCH Corporation (NCH), that they will not be prosecuted for violations of the Foreign Corrupt Practices Act (FCPA). According to the "letter agreement" issued to HMT, HMT agreed to disgorge nearly $2.7 million in profits to the DOJ as a result of HMT's employees and agents having paid approximately $500,000 in bribes to government officials in Venezuela and China.[1] Similarly, according to the "letter agreement" issued to NCH, NCH agreed to disgorge nearly $335,000 in profits generated as a result of its Chinese subsidiary bribing Chinese officials with cash, gifts, meals and entertainment.[2]

What makes these "letter agreements" noteworthy is that they were the first declination letters issued since the launch of the DOJ's pilot program (Pilot Program) on April 5, 2016,[3] in which: (i) a declination letter was issued; (ii) no fines or penalties were assessed against the companies; and (iii) the DOJ required the companies to disgorge any ill-gotten profits. While it may appear that the DOJ introduced a new tool—declinations with disgorgement—in resolving FCPA investigations of HMT and NCH, the fact that the DOJ required HMT and NCH to disgorge ill-gotten profits is not surprising given the requirements of the Pilot Program, as well as the fact that the DOJ often cooperates with the U.S. Securities and Exchange Commission (SEC) in investigating and resolving FCPA investigations.

When the Pilot Program was initially announced by the DOJ, much attention was given to the following three requirements for receiving full cooperation credit: (i) whether the company voluntarily self-disclosed; (ii) the degree to which the company cooperated in the DOJ's investigation; and (iii) the company's remediation efforts. However, previously issued declination letters, as well as the DOJ's Pilot Program Guidance, highlight a fourth critical requirement for obtaining full cooperation credit—the company's disgorgement of any profits received as a result of its FCPA violations. Indeed, the Pilot Program Guidance states that "even a company that voluntarily self-discloses, fully cooperates, and remediates will be required to disgorge all profits resulting from the FCPA violation."[4]

Furthermore, since the launch of the Pilot Program, the DOJ had issued three other declination letters to Nortek, Inc. (Nortek), Akamai Technologies, Inc.

1 DOJ Declination Letter to HMT, LLC (Sept. 29, 2016), *available at* https://www.justice.gov/criminal-fraud/file/899116/download

2 DOJ Declination Letter to NCH Corporation (Sept. 29, 2016), *available at* https://www.justice.gov/criminal-fraud/file/899121/download

3 On April 5, 2015, the DOJ announced its one-year FCPA enforcement pilot program intended to encourage voluntary self-disclosure, timely cooperation and remediation.

4 *See* Memorandum from Andrew Weissmann, Chief (Fraud Section), U.S. Dep't of Justice, *The Fraud Section's Foreign Corrupt Practices Act Enforcement Plan and Guidance* (Apr. 5, 2016), *available at* https://www.justice.gov/opa/file/838386/download.

(Akamai) and Johnson Controls, Inc. (Johnson Controls). While the declination letters issued by the DOJ to Nortek, Akamai and Johnson Controls did not require the companies to disgorge ill-gotten profits, in each instance, the DOJ viewed each company's disgorgement to the SEC as a positive factor in its decision not to prosecute.[5] In contrast, HMT and NCH are privately held companies, and as a result, the declination letters issued by the DOJ to these two companies required disgorgement.

Therefore, a key takeaway from the declination letters issued to HMT and NCH is that if the company is an issuer and subject to the jurisdiction of the SEC, the SEC will likely seek disgorgement through a non-prosecution agreement. In contrast, if the company is privately held like HMT and NCH, the DOJ may pursue and require disgorgement from the company. Furthermore, it appears likely that, even when a company voluntarily discloses, fully cooperates and remediates, that company will likely still need to disgorge profits (whether to the DOJ or the SEC) in order to be eligible for the full range of mitigation credit available under the Pilot Program.

Another notable takeaway from these recent declination letters is that, whether a company is dealing with the DOJ or the SEC, both agencies are committed to encouraging voluntary self-disclosure, timely cooperation and remediation, and both will require the same level of cooperation and disgorgement in order to be eligible for the full range of mitigation credit. Indeed, recent joint efforts by the DOJ and the SEC have led to an increase in FCPA enforcement actions and related declinations in 2016.[6] Recent settlements and declinations further demonstrate that the DOJ and the SEC will reward companies that voluntarily disclose misconduct, fully cooperate and appropriately remediate. However, while recent declinations may not have contained undertakings or admissions by companies, the declinations were publically released and included detailed allegations of wrongdoing by the companies. As a result, companies should consider the potential reputational backlash that may stem from a declination letter issued by the DOJ.

Self-reporting and cooperation with regulators is not a "check-the-box" strategy. Whether proactive or reactive, once a company decides to cooperate, it should be prepared to present the DOJ and/or the SEC with evidence of a thorough internal investigation, remedial efforts taken in response to the issues identified by the company, and improvements to internal processes implemented as a result of the conduct that was uncovered during an internal investigation. In addition, the declination letters issued to HMT and NCH highlight the need for companies to engage experienced counsel to navigate cooperating with the DOJ and the SEC, including options for potentially disgorging profits.

---

5 DOJ Declination Letter to Nortek, Inc. (June 7, 2016), *available at* https://www.justice.gov/criminal-fraud/file/865406/download; *see also* DOJ Declination Letter to Akamai Technologies, Inc. (June 7, 2016), *available at* https://www.justice.gov/criminal-fraud/file/865411/download; DOJ Declination Letter to Johnson Controls (June 21, 2016), *available at* https://www.justice.gov/criminal-fraud/file/874566/download.

6 SEC Enforcement Actions: FCPA Cases *available at* https://www.sec.gov/spotlight/fcpa/fcpa-cases.shtml; *see also* https://www.justice.gov/criminal-fraud/case/related-enforcement-actions/2016.

Examining Sanctions for Accountants under SEC Rule of Practice 102(e)(1)

Joshua Nichols
Associate
+1 (312) 609 7724
jnichols@vedderprice.com

On August 5, 2016, Commissioner Michael S. Piwowar of the U.S. Securities and Exchange Commission (SEC) delivered a heated dissent in an appeal from an administrative law judge's ruling in an enforcement action against two certified public accountants. Commissioner Piwowar dissented from the opinion of Chair Mary Jo White and Commissioner Kara M. Stein. Specifically, Commissioner Piwowar accused Chair White and Commissioner Stein of "destr[oying] . . . the Respondents' professional careers" by levying an impermissible "punitive sanction" under Rule 102(e)(1) of the SEC's Rules of Practice and Rules on Fair Fund and Disgorgement Plans.

Rule 102 governs "Appearance and Practice Before the Commission" by professionals such as accountants and attorneys. 17 CFR § 201.102. Rule 102(e), in particular, governs the "suspension and disbarment" of persons appearing and practicing before the SEC. This article focuses specifically on the SEC's suspension and disbarment authority under Rule 102(e)(1), which applies when a professional is deemed "not to possess the requisite qualification to represent others," "to be lacking in character or integrity or to have engaged in unethical or improper professional conduct," or "to have willfully violated, or willfully aided and abetted the violation of any provision of the Federal securities laws or the rules and regulations thereunder." 17 CFR § 201.102(e)(1).

In addition to containing conspicuously sharp language, and publicly demonstrating a rift between SEC commissioners, the dissent provided candid and practical guidance on the sanctions available to the SEC under Rule 102(e)(1), as well as the impact of each such sanction. For purposes of the dissent, Commissioner Piwowar used the terms "suspension" and "bar" as distinct punishments in which a "suspension" indicates a denial of right to practice before the SEC for a certain amount of time, after which a respondent is reinstated,[1] whereas a "bar" indicates either an outright denial of right to practice without temporal limitation,[2] or a denial of right to practice with the right to apply for reinstatement after a fixed amount of time.[3] In short, the dissent discussed three possible sanctions under Rule 102(3): (1) a temporary suspension; (2) an outright bar; and (3) a bar with the ability to apply for reinstatement after passage of a certain amount of time.[4]

---

1 *See, e.g., In the Matter of Halpern & Associates LLC and Barbara Halpern, CPA,* No. 3-16399 (Feb. 26, 2016) (Respondent "denied the privilege of appearing or practicing before the Commission as an accountant for one year").

2 *See, e.g., In the Matter of Reid A. Hackney, CPA,* No. 3-17047 (Jan. 12, 2016) (Respondent "denied the privilege of appearing or practicing before the Commission as an accountant").

3 *See, e.g., In the Matter of David S. Krueger, CPA,* No. 3-17165 (Mar. 10, 2016) (Respondent "denied the privilege of appearing or practicing before the Commission as an accountant . . . [but] [a]fter one year from the date of this order, Respondent may request that the Commission consider his reinstatement").

4 For the sake of consistency and clarity, this article adopts Commissioner Piwowar's use of the terms "suspension" and "bar."

On June 27, 2014, Administrative Law Judge (ALJ) Carol Fox Foelak entered an Initial Decision in an administrative proceeding captioned *In the Matter of John J. Aesoph, CPA and Darren M. Bennett, CPA.* In that case, Aesoph and Bennett (Respondents) had been accused of improper professional conduct under Rule 102(e)(1) and Section 4C of the Securities Exchange Act of 1934 for failing to comply with PCAOB standards when, in connection with a year-end audit of a bank's financial statements, they "failed to subject . . . loan loss estimates—one of the highest risk areas of the audit—to appropriate scrutiny."[5] The SEC's Division of Enforcement sought suspensions of Aesoph and Bennett for three years and two years, respectively. After a nine-day hearing, the ALJ found that Respondents had engaged in improper professional conduct and suspended Aesoph for one year and Bennett for six months. Respondents appealed the Initial Decision. The SEC's Division of Enforcement cross-appealed the Initial Decision, arguing that the sanctions imposed by the ALJ were too lenient.

On appeal, the SEC—through Chair White, Commissioner Stein and Commissioner Piwowar—issued a Corrected Opinion, affirming the ALJ's finding of improper professional conduct. As to sanctions, Chair White and Commissioner Stein enhanced Respondents' penalty, finding that it was "in the public interest to deny Respondents the privilege of appearing or practicing before us with a right for Aesoph to apply for reinstatement after three years and for Bennett to apply for reinstatement after two years."[6] In short, the Division of Enforcement had originally sought suspensions of three years and two years for Aesoph and Bennett, respectively, and the ALJ ordered suspensions of one year and six months, respectively. On appeal, the SEC ordered that Aesoph and Bennet be *barred* with a right to apply for reinstatement after three years and two years, respectively.

This appeal and the dissent provide—directly and implicitly—several key takeaways for accountants facing enforcement actions under Rule 102(e)(1), as well as their respective counsel:

1. Sanctions under Rule 102(e) are for remedial—not punitive—purposes.

As an initial matter, Commissioner Piwowar noted that "'the [SEC] may impose sanctions for a remedial purpose, but not for punishment' under Rule 102(e)."[7] Remedial sanctions are assessed by the SEC by using the "*Steadman* factors," which are: (1) egregiousness of respondent's actions; (2) isolated or recurrent nature of the infraction; (3) degree of scienter involved; (4) sincerity of

5 *In the Matter of John J. Aesoph, CPA and Darren M. Bennett, CPA,* No. 3-15168 (June 27, 2014), at 2.

6 *In the Matter of John J. Aesoph, CPA and Darren M. Bennett, CPA,* No. 3-15168 (Aug. 5, 2016), at 1.

7 *In the Matter of John J. Aesoph, CPA and Darren M. Bennett, CPA,* No. 3-15168 (Aug. 5, 2016), at Dissent p. 1 (quoting *McCurdy v. SEC*, 396 F.3d 1258, 1264 (D.C. Cir. 2005)).

respondent's assurances against future violations; (5) respondent's recognition that his or her conduct was wrong; and (6) the likelihood of opportunities for future violations based on the respondent's occupation.[8] In addition to the *Steadman* factors, the SEC also considers deterrence and "consisten[cy] with Commission precedent" when assessing sanctions under Rule 102(e)(1).[9] Commissioner Piwowar found the imposition of three-year and two-year bars against Respondents—a more onerous sanction than the ALJ originally ordered and more onerous than even the sanction sought by the Division of Enforcement—to be excessive to the point of being punitive.

2. A bar—either indefinite in nature or with a right to apply for reinstatement after a fixed period of time—is harsher than a suspension.

Commissioner Piwowar posited that the sanction ordered in the Corrected Opinion was harsher than the sanction sought by the Division of Enforcement because "[t]here is a significant difference between a three-year and two-year suspension as compared to a bar with the right to apply for reinstatement after three years and two years."[10] Specifically, while Respondents "would be free to resume practicing or appearing before the [SEC] when [a] suspension ends," a bar with a right to apply for reinstatement only provides that "once the requisite time period has passed, Respondents will only be no longer prohibited from seeking reinstatement from the [SEC]."[11]

The distinction between the automatic resumption of practice before the SEC associated with a suspension and the end to a prohibition from seeing reinstatement after a certain amount of time is critical. The dissent identifies two additional hurdles faced by respondents who are barred from practice as opposed to those who are suspended. First, the dissent noted the significance of "[t]he amount of . . . resources (e.g., retention of counsel) needed to navigate the process," concluding that costs "may deter some individuals from even attempting to petition for reinstatement."[12] Second, the reinstatement process itself is onerous. Commissioner Piwowar noted that "[p]etitions for accountant reinstatements are first evaluated by [the SEC's] Office of the Chief Accountant and, if satisfactory, are then recommended to the Commission for approval."[13] Importantly, "[t]here are no deadlines for the Commission or its staff to complete this process."[14] Consequently, in Commissioner Piwowar's experience, "the reinstatement process, even if successful, can take years to complete after the requisite time period has expired."[15] Importantly, reinstatement is permissive, not mandatory, so the arduous reinstatement process could end in defeat for a respondent.[16]

---

8 *In the Matter of John J. Aesoph, CPA* and Darren M. Bennett, CPA, No. 3-15168 (June 27, 2014), at 36.

9 *Id.* at 36–37, n.40.

10 *In the Matter of John J. Aesoph, CPA and Darren M. Bennett, CPA*, No. 3-15168 (Aug. 5, 2016), at Dissent p. 2.

11 *Id.*

12 *Id.* at 2, n.9.

13 *Id.* at 2.

14 *Id.*

15 *Id.*

16 *Id.* (noting that the SEC "may, but is not obligated [to], reinstate a person 'for good cause shown'"); *In the Matter of James M. Schneider, CPA*, No. 3-14171 (July 22, 2016) ("the Commission *may* reinstate the privilege to appear and practice before the Commission 'for good cause shown'" (emphasis added)).

3. A bar with a right to apply for reinstatement after a set period of time is harsher than an outright bar.

Commissioner Piwowar also posits that a bar with the right to apply for reinstatement after a set amount of time is actually *harsher* than an outright bar. Specifically, he cautions that "to the extent that providing a right to apply for reinstatement after a certain period of time creates the appearance of moderation to an otherwise permanent bar, that perception is false."[17] His reasoning is straightforward: with an outright bar, a respondent may apply for reinstatement "at any time," while a respondent who is barred for a certain amount of time "must wait until the stated time period has elapsed before filing [for reinstatement]."[18] Moreover, because there is no guarantee that a respondent will be reinstated after a temporal bar, "the right to apply for reinstatement can be illusory."[19] Finally, Commissioner Piwowar notes that the existence of a specific period of time before a respondent can apply for reinstatement does not necessarily impact the "good cause" analysis that governs whether reinstatement will be granted.[20] For example, while the sanction of a bar with the right to apply for reinstatement after two years seems facially less harsh than an outright bar, the respondent with the right to apply for reinstatement after two years is in no better position than the respondent with an outright bar when it comes to a "good cause" analysis, because the SEC's rules "do not address whether the presence, or absence, of a period before which a respondent has a right to apply for reinstatement . . . should affect the 'good cause' analysis."[21] In light of this, Commissioner Piwowar warns that "any respondent in [an SEC] enforcement action (including a settlement with the [SEC]) should be on notice of the possibility that, in consideration of a reinstatement petition, the inclusion of a right to apply for reinstatement period may have no effect on a future [SEC] decision as [to] whether to grant reinstatement."[22]

4. On appeal from an ALJ's initial decision, the SEC is willing to enhance the original sanctions.

As demonstrated by Chair White and Commissioner Stein, the SEC will order sanctions on administrative appeal that go beyond those originally entered by an ALJ. Here, as noted above, the ALJ ordered that Respondents be suspended (i.e., reinstated at the conclusion of the suspension period) for periods of one year and six months, respectively. Respondents appealed the Initial Decision (as did the SEC) and on appeal received substantially heightened sanctions.

---

17 *In the Matter of John J. Aesoph, CPA and Darren M. Bennett, CPA*, No. 3-15168 (Aug. 5, 2016), at Dissent p. 2, n.9.

18 *Id.*

19 *Id.* at 2.

20 *Id.*

21 *Id.* at n.12.

22 *Id.*

5. The SEC is willing to order sanctions beyond those sought by the Division of Enforcement.

In this case, the Division of Enforcement was seeking to have Respondents suspended (i.e., reinstated at the conclusion of the suspension period) for three years and two years, respectively. Commissioner Piwowar pointed out that there was no confusion regarding what exactly the Division of Enforcement was seeking:

> At oral argument, I specifically asked counsel for the Division to clarify whether the Division was seeking a three-year and two-year suspension for [Respondents], respectively, or whether he was seeking a bar with the right to apply for reinstatement after three years and two years. Counsel for the Division responded the former.[23]

Yet Chair White and Commissioner Stein ordered that Respondents be barred from practicing before the SEC for three years and two years, respectively, with the right to seek reinstatement at the conclusion of those periods. As pointed out by Commissioner Piwowar, this type of sanction is significantly harsher than what the Division of Enforcement sought (and, in fact, as harsh as possible under Rule 102(e)(1)).

The SEC has been transparent in its efforts to pursue "gatekeepers," who the SEC deems to have violated federal securities laws, rules and/or regulations.[24] Importantly, the SEC has stated that its gatekeeper liability enforcement actions have been brought "increasingly against . . . individuals."[25] In these cases, the SEC has sought to go "beyond the standard disgorgement, civil money penalties and injunctions," and has placed an emphasis on obtaining "additional forward-looking . . . remedies for associated persons, including suspensions [and] bars."[26]

Statistics show that the SEC has been making good on its promises. As of early October 2016, the SEC had issued 32 enforcement releases regarding individual CPA respondents since the beginning of the calendar year.[27] Of those 32 releases, 14 involved sanctions under Rule 102(e)(1).[28] Of those 14 releases, the SEC ordered a bar with a right to apply after a certain period of time—what Commissioner Piwowar deemed to be the harshest sanction, equivalent to the "destruction of [a respondent's] professional career"—over 64% of the time. The SEC ordered the least harsh sanction—a suspension resulting in reinstatement after a certain period of time—only once. As the incoming administration of President-Elect Donald Trump begins to install new appointees and implement its enforcement priorities, it remains to be seen how, if at all, the sanctions landscape may change under Rule 102(e)(1). Vedder Price will continue to monitor developments in future enforcement actions against "gatekeepers" and in particular, the sanctions sought in those cases.

---

23 *Id.* at 1–2.

24 *See, e.g., Highlights from SEC Speaks 2016: Enforcement and Litigation Trends,* Vedder Price P.C., Feb. 22, 2016, *available at* http://www.vedderprice.com/highlights-from-sec-speaks-2016/#Gatekeepers.

25 *Id.*

26 *Id.*

27 The source for these allegations is the SEC's "Accounting and Auditing Enforcement Releases" page.

28 An additional ten releases involved suspensions under Rules 102(e)(2) and 102(e)(3), which deal with, *inter alia*, accountants whose license "has been revoked or suspended in any State," who have "been convicted of a felony or a misdemeanor involving moral turpitude," or who have been enjoined from committing, or found liable for committing or aiding and abetting a violation of the federal securities laws based on actions before the SEC or in a case brought by the SEC. These Rules, and related releases, fall outside the scope of this article.

Government Enforcement and Securities Litigation Groups

The firm's Government Enforcement and Special Investigations group and its Securities Litigation group regularly represent companies, officers and directors, board committees, broker-dealers, investment advisers, mutual funds, financial institutions, accounting professionals and other individuals in a broad range of government and regulatory investigations, internal investigations, white collar criminal investigations, private securities class actions, shareholder derivative actions and other litigation matters. Our experienced team includes former attorneys at the U.S. Securities and Exchange Commission, former prosecutors with the U.S. Department of Justice and former senior staff with self-regulatory organizations and financial services companies.

Chicago

Thomas P. Cimino, Jr. (Chair, Financial Services Litigation Group, and Co-Editor)
+1 (312) 609 7784

Junaid A. Zubairi (Chair, Government Enforcement and Special Investigations Group, and Co-Editor)
+1 (312) 609 7720

Rachel T. Copenhaver (Co-Editor)
+1 (312) 609 7514

James A. Arpaia .... +1 (312) 609 7618
David E. Bennett............... +1 (312) 609 7714
Brooke E. Conner .... +1 (312) 609 7529
Rebecca L. Dandy............ +1 (312) 609 7923
James V. Garvey............... +1 (312) 609 7712
Ryan S. Hedges................ +1 (312) 609 7728
James M. Kane .... +1 (312) 609 7533
Ludwig E. Kolman............. +1 (312) 609 7566
Kirsten W. Konar .... +1 (312) 609 7588
Brian W. Ledebuhr............ +1 (312) 609 7845
Randall M. Lending........... +1 (312) 609 7564
Joseph M. Mannon........... +1 (312) 609 7883
Martin McElligott............... +1 (312) 609 7876
Daniel C. McKay, II............ +1 (312) 609 7762
Michael R. Mulcahy .... + 1 (312) 609 7513
Joshua Nichols .... +1 (312) 609 7724
Joshua J. Orewiler .... +1 (312) 609 7639
Jeanah Park...................... +1 (312) 609 7532
David A. Sturms................ +1 (312) 609 7589
Aruna Subramanian.......... +1 (312) 609 7787
William W. Thorsness .... +1 (312) 609 7595
John W. Whittlesey .... +1 (312) 609 7615
Gregory G. Wrobel............ +1 (312) 609 7722

Los Angeles

Germain D. Labat ....+1 (424) 204 7727

New York

Joshua A. Dunn ....+1 (212) 407 7791
John H. Eickemeyer..........+1 (212) 407 7760
Joel S. Forman ....+1 (212) 407 7775
Daniel C. Green ....+1 (212) 407 7735
Charles J. Nerko ....+1 (212) 407 6933
Marc B. Schlesinger ....+1 (212) 407 6935

VedderPrice

About Vedder Price

Vedder Price is a thriving general-practice law firm with a proud tradition of maintaining long-term relationships with our clients, many of whom have been with us since our founding in 1952. With approximately 300 attorneys and growing, we serve clients of all sizes and in virtually all industries from our offices in Chicago, New York, Washington, DC, London, San Francisco, Los Angeles and Singapore.

Stay Connected