

The SEC's First Quarter: A Review

The first quarter of 2020 ended with the markets plummeting to new lows and much of the country shuttered in an effort to avoid transmitting COVID-19. SEC Enforcement finished the quarter by not filing any new cases in the final days of the period.

During the first quarter the agency prevailed in four jury trials while filing a series of actions. The cases involved a range of issues including those focused on investment advisers, manipulation, insider trading, financial fraud and the FCPA. While the number cases initiated during the first quarter of the decade would not suggest a record setting pace, what is more important is the type and quality of the cases. The focus was, and in probability will continue to be, the protection of main street investors. If, as has been repeatedly stated, that is the goal, then the question is whether the types of cases being investigated and brought is accomplishing that goal.

The answer, at least in part, should be apparent from an examination of the cases brought. Below is a sampling of those action.

Offering frauds: This was far and away the largest category of cases initiated during the quarter. The actions were based on a variety of fraudulent schemes. Some were simple frauds that were little more than Ponzi schemes. Others were more sophisticated but ended with the same result – the investors lose. In *SEC v. Findley*, Civil Action No. 3:20-cv-00397 (D.Conn. March 25, 2020) Bernard Findley used a firm called Halitron, Inc. that he controlled to fleece investors and enrich himself through a debt offering. Investors were solicited to purchase the corporate debt of a firm that appeared to have assets but really had little to offer except the opportunity to buy discounted shares. At the time of the sales Mr. Findley manipulated the share price, using a series of false press releases. The result: Investors purchased the debt; Mr. Findley took the cash. The investors got the shares. While the deal had some of the hallmarks of a corporate transaction, in reality it was a sham. See also *SEC v. Curative Biosciences, Inc.*, Civil Action No. 18-cv-925 ((C.D. Cal. Verdict March 11, 2020)(insider used a variety of devices to secretly sell shares into the market and recycle the money back to himself; jury returned a verdict

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in favor of Commission).

Perhaps more typical of many of the cases in this area is *SEC v. ARO Equity, LLC*, Civil Action No. 1:20-cv-10027 (D. Mass. Filed Jan. 8, 2020). Defendant Thomas Renison was a state licensed insurance agent who had been barred from the securities business by the state of Maine and from associating with investment advisers by the Commission. Nevertheless, Mr. Renison sold notes in his firm, ARO Equity, primarily to senior citizens, stressing safety but omitting mention of his past. The safety seemed to be missing as the investor capital was used to fund other businesses – they failed. Large fees were paid prior to that time to others, however. In the end the investors got nothing. The complaint alleges violations of Exchange Act Section 10(b), Securities Act Section 17(a), and Advisers Act Section 206(1) and 206(2). The case is on-going.

Investment advisers: Another group of cases centered on investment advisers. This category of enforcement actions has continued to grow in recent years and is at least equal in size to what had been for year the focus of Enforcement – corporate actions. The cases in this area center on a series of topics including the overcharged fees, undisclosed conflicts, a failure to adhere to or implement disclosed policies and the misappropriation of client funds.

Typical of these cases is *SEC v. Westport Capital Markets, LLC*, Civil Action No. 3:17-cv-02064 (C.D. Cal. Verdict March 16, 2020), an action in which the Commission secured a favorable jury verdict. Westport is a dual registered investment adviser and broker-dealer controlled by Christopher McClure, also a named defendant. The case centered on two points. First, Defendant made a deal with an underwriter to secure shares being underwritten at a discount. Those shares were taken into the firm's inventory and later resold to advisory clients at face value without disclosing that the seller was the firm or the arrangements. Second, mutual fund shares were sold to advisory clients on which the firm was paid 12b-1 fees without disclosure. The jury concluded that the Defendants had violated Advisers Act Sections 206(1), 206(2), 206(3) and 206(7). *See also In the Matter of Nay Ventures*, Adm. Proc. File No. 3-19728 (March 12, 2020)(Exempt Texas adviser failed to properly comply with the policies and procedures it told investors had been adopted); *In the Matter of Cannell Capital, LLC*, Adm. Proc. File No. 3-19689 (Feb. 4, 2020) (Registered adviser failed to maintain and implement an effective insider trading policy).

Insider trading: The agency has long focused on cases in this area. *SEC v. Chen*, Civil Action No. 1:18 – cv-1657 (D. Mass. Verdict Feb, 3, 2020) is typical of the actions brought during the first quarter. In this case two couples lived in the same small town, Mr. & Mrs. Charlie Chen and a second Couple. Each couple had two daughters attending the same high school. Husband of Couple was employed at VistaPrint and regularly obtained inside information about the firm and its financial results. Over a two-year period Mr. Chen repeatedly purchased options VistaPrint's stock. In every instance except two he had profitable trades. He had, however, correctly predicted the price movement of the stock in the two instances which were exceptions, he just did not make a profit. When the FBI questioned Mr. Chen about the trading, he denied knowing

anyone at VistaPrint. When the agents asked about Husband, Mr. Chen claimed he only knew him through his daughters. Later, when questioned by the SEC staff during its investigation, Mr. Chen invoked the Fifth Amendment. The jury returned a verdict in favor of the Commission.

Manipulation: This is another traditional focus of SEC Enforcement. An example of the cases brought during the quarter in this area is *SEC v. Bajic*, Civil Action No. 120-CV-00007 (S.D.N.Y. Filed Jan. 2020), an international market manipulation allegedly executed by a series of defendants. Those defendants included Steve Bajic, Rajesh Taneja, Blacklight S.A. and eleven other individuals and off-shore entities. Mr. Bajic is Canadian; Mr. Taneja is a citizen of Vietnam; Blacklight is a controlled foreign corporation; each entity defendant is off-shore. Various off-shore entities were used to disguise the public company insiders of various firms who participated in the scheme. Their stock was dumped on the public as the scheme progressed and the share price was manipulated. Overall about \$7.7 million was reaped as profits over a four-year period. The complaint alleges violations of Securities Act Sections 5(a), 5(c) and 17(a) and Exchange Act Section 10(b). See also *SEC v. Ciapala*, Civil Action No. 1:20-cv-00008 (S.D.N.Y. Filed Jan. 2, 2020)(companion action). Each case is in litigation.

FCPA: The Foreign Corrupt Practices Act is another long time focus of SEC Enforcement, a trend that continued in the first quarter of 2020 with the filing of *In the Matter of Cardinal Health, Inc.*, Adm. Proc. File No. 3-19718 (Feb. 28, 2020). Cardinal is a global healthcare firm based in Ohio. It entered the Chinese market in 2010, acquiring a firm that was the exclusive distributor in that market for a large European dermo cosmetic company. After determining that the risk was low, Cardinal decided not to impose its full array of internal controls, which included FCPA provisions, on the firm. Over a four year period, beginning in 2013, employees of the new subsidiary were given about \$250 million in marketing funds. There was little documentation or control. Significant portions of those funds were transmitted to state officials. Over the period Cardinal profited by about \$5.4 million. Its subsidiary has been enriched. The Order alleged violations of Exchange Act Sections 13(b)(2)(A) and 13(b)(2)(B). The action was resolved with a consent to a cease and desist order based on the sections cited in the Order and payment of disgorgement in the amount of \$5.4 million along with prejudgment interest of \$916,887. The firm will also pay a penalty of \$2.5 million. The Commission considered the fact that Cardinal self-reported, cooperated and undertook remedial acts.

Conclusion: The first quarter of the new decade opened with promise and ended with the United States and much of the world shuttering for survival to try and evade a virus. The shift from promise to survival has been difficult to say the least.

No doubt that same shift has been difficult for the Commission. Nevertheless, the agency filed a series of actions. Some were complex. Others were simple. Some were in traditional areas like insider trading and FCPA. The focus over the quarter has been the retail investors, a point clearly addressed by some of the cases as illustrated above. If that is the litmus test rather than numbers of cases brought the question is if the goal

was achieved. The answer to that question is, like many things, in the eye of those who behold the actions above. The trends being etched by the program are also evident from the cases above – the work output of the Division of Enforcement.