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April 4, 2017

The Acting SEC Chair Has Trimmed Enforcement's Subpoena Power

The following is written by Laura Anthony, Esq., a going public attorney focused on OTC listing requirements, direct public offerings, going public transactions, reverse mergers, Form 10 and Form S-1 registration statements, SEC compliance and OTC Market reporting requirements.

In early February 2017, acting SEC Chair Michael Piwowar revoked the subpoena authority from approximately 20 senior SEC enforcement staff. The change leaves the Director of the Division of Enforcement as the sole person with the authority to approve a formal order of investigation and issue subpoenas. Historically, the staff did not have subpoena power; however, in 2009 then Chair Mary Shapiro granted the staff the power, in the wake of the Bernie Madoff scandal. Chair Shapiro deemed the policy to relate solely to internal SEC procedures and, as such, passed the delegation of power without formal notice or opportunity for public comment.

This is the beginning of what I expect will be many, many changes within the SEC as the new administration changes the focus of the agency from Mary Jo White's broken windows policies to supporting capital formation. The mission of the SEC is to protect investors, maintain fair, orderly and efficient markets and facilitate capital formation. Although each mission should be a priority, the reality is that the focus of the SEC changes based on its Chair and Commissioners and political pressure. Mary Jo White viewed the SEC enforcement division and the task of investor protection as her top priority. Mike Piwowar and presumably Jay Clayton are shifting the top priority to capital formation.

Acting Chair Piwowar has been a vocal critic of both the staff subpoena power and the manner in which the power was created since its inception. He has also been a vocal critic of the SEC's investigative power, believing it has too much power and too little oversight.

Mr. Piwowar made a speech in 2013 to the LA County Bar, being very clear about his views on the SEC and its operations. At the time, he talked about enforcement and that investigations should be focused on evidence of wrongdoing, to wit: lying, cheating and stealing. He stated that the SEC must only concern itself with “the facts known to them and the reasonable inferences from those facts” and cautioning that a Commissioner “should never suggest, vote for, or participate in an investigation aimed at a particular individual for reasons of animus, prejudice, or vindictiveness.” In that regard, he recognizes that “the mere existence of an investigation – even without taking any subsequent enforcement action – carries with it the power to defame and destroy.”

Piwowar then went on to specifically address the process for the issuance of a formal order of investigation, which brings with it the power to subpoena witnesses, documents and testimony. He stated, “Historically, formal orders have been approved by the Commission. This process usually required the staff to prepare a memorandum for the Commission containing a summary of the case and any possible violations, and recommending issuance of the order. Although it was rare, if ever, for the Commission to deny a request for a formal order, the process brought forth a certain level of focus and review from not only the Division of Enforcement, but also staff in the Office of the General Counsel as well as the other divisions, such as Corporation Finance, Trading and Markets, and Investment Management.” Piwowar continued, “[B]ut in a significant departure from past practice, in August 2009, the Commission delegated the authority to issue formal orders to the Director of Enforcement, on the grounds that such delegation would expedite the investigative process by reducing the time and paperwork previously associated with obtaining Commission authorization prior to issuing subpoenas.”

Moreover, clearly this change made formal orders much easier to obtain, as evidenced by the fact that the issuance of these orders doubled in the years following. Mr. Piwowar stated, “[t]he delegation of authority for approval of formal orders was deemed by the Commission to relate solely to agency organization, procedure, and practice, and therefore not subject to the notice and comment process under the Administrative Procedure Act. The mere fact that we can institute certain rules without obtaining comment from the public does not necessarily mean that we should. Given the significant ramifications for persons who are on the receiving end of a subpoena issued pursuant to a formal order, we should make sure that public comment is allowed on any review of the formal order process.”

It is no surprise, then, that Piwowar remanded this provision as soon as he was in a position to do so.

Potential Additional Changes with Enforcement and SEC Policy

Incoming SEC Chair Jay Clayton is largely thought to be pro-business and likely sympathetic to large financial institutions. Moreover, the SEC still must appoint additional Commissioners and a new Director of Enforcement. The individuals that fill these roles will undoubtedly greatly influence policy.

Mr. Clayton has made public comments criticizing the Dodd-Frank Act for over-regulating the financial services industry. As such, I would expect to see changes in Dodd-Frank and a lack of interest in enforcing some provisions while they remain.

Clayton has also publicly criticized the Foreign Corrupt Practices Act (FCPA) as putting U.S. businesses at a huge disadvantage against competitors not subject to this law, such as those domiciled in other countries. Clayton specifically stated that U.S. companies were disproportionately affected by a "virtually stand-alone approach to deterring foreign corruption" that "places significant costs on companies subject to the FCPA as compared to their competitors that are not." Trump also spoke against the FCPA. Accordingly, it is very likely that enforcement of FCPA violations will take a low priority going forward.

Another area in which Clayton will not likely focus is enforcement of whistleblower retaliation cases. Over the past few years the SEC has vigorously pursued enforcement proceedings against companies thought to retaliate against or even chill whistleblower activity. The SEC has even taken action against contract provisions in employment or severance agreements that could be deemed to prevent or impede whistleblower activity. Likewise, the Financial Choice Act 2.0 contains provisions reducing the availability of whistleblower awards.

On February 3, 2017, President Trump signed an executive order entitled "Core Principles for Regulating the United States Financial System." The order set forth seven principles for regulating the financial system, including:

(a) empower Americans to make independent financial decisions and informed choices in the marketplace, save for retirement, and build individual wealth;

(b) prevent taxpayer-funded bailouts;

(c) foster economic growth and vibrant financial markets through more rigorous regulatory impact analysis that addresses systemic risk and market failures, such as moral hazard and information asymmetry;

(d) enable American companies to be competitive with foreign firms in domestic and foreign markets;

(e) advance American interests in international financial regulatory negotiations and meetings;

(f) make regulation efficient, effective and appropriately tailored; and

(g) restore public accountability within federal financial regulatory agencies and rationalize the federal financial regulatory framework.

The executive order, although general, certainly is very telling in regard to the philosophy of this administration, including that which is related to over-regulation and enforcement by the SEC.

Administrative Proceedings

The SEC Penalties Act, as written in its beginning form, treats administrative court and federal court proceedings equally. However, the administrative court process is not an equal forum and, based on a barrage of negative attacks, including lawsuits, appeals and media coverage, requires review and attention. An analysis by The Wall Street Journal in 2015 indicated that in the last five years, the SEC has won 90% of cases brought in its own administrative courts but only 69% of cases brought in federal court. Part of the disparity could be that the SEC chooses to settle or drop "losing" claims, but that still leaves a large discrepancy.

Moreover, the Dodd-Frank Act, enacted in 2010, for the first time granted the SEC the authority to impose civil penalties in administrative proceedings against any person the SEC claims violated the securities laws, regardless of whether that person or firm is in the securities business. In other words, Dodd-Frank opened the doors for the SEC's own administrative proceedings to be just another forum for the pursuit of any securities law violations. Common sense tells us that this change, seven years ago, directly relates to the uproar in the defensive bar.

Over the past years a slew of cases have been filed challenging the SEC's power in administrative actions and the administrative process. With little fanfare or public announcement, the SEC under Jay Clayton may cut back dramatically on the use of administrative proceedings, quietly ending or at least greatly reducing this battle until more formal policy changes are brought.

The Author

Attorney Laura Anthony
Founding Partner
Legal & Compliance, LLC
Corporate, Securities and Going Public Attorneys
LAnthony@LegalAndCompliance.com

Securities Law Blog is written by Laura Anthony, Esq., a going public lawyer focused on OTC Listing Requirements, Direct Public Offerings, Going Public Transactions, Reverse Mergers, Form 10 Registration Statements, and Form S-1 Registration Statements. Securities Law Blog covers topics ranging from SEC Compliance, FINRA Compliance, DTC Chills, Going Public on the OTC, and OTCQX and OTCQB Reporting Requirements. Ms. Anthony is also the host of LawCast.com, the securities law network.

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