

CORPORATE AND SECURITIES LITIGATION

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Decision Examines Remedies in SEC Enforcement Actions

The federal securities laws provide a broad array of civil remedies that the Securities and Exchange Commission (SEC) may seek in enforcement proceedings. Among the available remedies are a permanent injunction against future securities violations,¹ a bar preventing the defendant from serving as an officer or a director of a public company,² the disgorgement of ill-gained profits³ and the imposition of civil penalties.⁴

Although SEC enforcement actions are civil actions (requiring only a "preponderance of evidence" standard of proof), the available remedies may be harsh punishment for a defendant found to have violated the federal securities laws.

As practitioners know, the SEC, both in enforcement actions and settlement discussions, tends to view virtually any securities law violation as ipso facto requiring imposition of the full panoply of remedies, regardless of the nature and circumstances of the underlying violation or the personal consequences to the defendant. The stated justifications are generally uniformity and deterrence of future violators.

'SEC v. Snyder'

Recently, some courts have sought to balance the SEC's desire to instill fear in would-be violators with the need to tailor remedies to the circumstances of a specific case. In one such case, U.S. District Judge Keith P. Ellison in the Southern District of Texas considered the appropriate remedies to impose upon Bruce Snyder, former vice president and chief accounting officer of Waste Management Inc. (WMI). *SEC v. Snyder*, Civ. No. H-03-04658 (S.D. Tex. Aug. 22, 2006) (remedies opinion).

A jury found Mr. Snyder liable for filing a materially false and misleading Form 10-Q for



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the first quarter of 1999. The 10-Q was misleading because it included certain "nonrecurring" adjustments to income without disclosing that the adjustments were unlikely to occur regularly in WMI's business. As a result, WMI's financial performance appeared better than it actually was. The jury also found Mr. Snyder liable for insider trading based on a stock sale that he made after filing the 10-Q, finding that he intentionally or recklessly traded upon both the nonpublic information that the 10-Q was misleading and that the company expected to fall short of its second quarter earnings targets, which would cause the stock price to fall. After the verdict, Mr. Snyder moved for judgment as a matter of law, contending that reasonable jurors could not have reached those verdicts based on the evidence presented.⁵

Regarding the false reporting claim, Mr. Snyder argued that no reasonable jury could have found that he acted with the requisite scienter: either "severe recklessness" or "an extreme departure from the standards of ordinary care." At trial, Mr. Snyder established that WMI's auditor, Arthur Andersen, approved the 10-Q before it was filed. Indeed, three accountants from Andersen testified that they, like Mr. Snyder, believed that the 10-Q was not materially false or misleading. Mr. Snyder argued that if three outside accountants believed the disclosures in the 10-Q were adequate, it was not rational for a jury to find that Mr. Snyder was severely reckless for believing the same thing.

Mr. Snyder also sought judgment as a matter of law on the insider trading claim. The jury had found that Mr. Snyder sold 2,700 shares of WMI

stock based on material nonpublic information that WMI's stock price was about to drop and had done this "knowingly and with an intent to deceive." Mr. Snyder contended that the jury could not reasonably have found any dishonest motive or intent because, on the same day that he sold the 2,700 WMI shares, he had purchased 8,700 shares. Indeed, Mr. Snyder argued, it made no sense that he would sell his 2,700 shares to gain an illicit benefit from inside information that the price was going to fall, and yet on the same day purchase an even larger number of shares.

Judge Ellison denied Mr. Snyder's motion, finding that the record contained sufficient evidence to support the jury verdicts and emphasizing that the court's role was not to make credibility determinations or weigh the evidence. Although concluding that Mr. Snyder's evidence was "not so overwhelming" as to justify throwing out the jury verdict, the court apparently agreed with his assessment of the facts. The court described him as having presented "substantial evidence" that he acted in good faith in filing the 10-Q and that the purchase of 8,700 shares "does tend to show that Defendant did not knowingly or recklessly trade on the basis of material, nonpublic information."

The finding that Mr. Snyder, a certified public accountant, had engaged in securities violations inflicted "devastating effects" independent of any additional remedies. Mr. Snyder's "prospects of ever again working for a public company are nonexistent, and his chances for employment in accounting at a level even remotely commensurate with his education and experience are very close to nonexistent." *Snyder*, Aug. 22, 2006 op. at 20. Indeed, after leaving WMI, the only accounting work that Mr. Snyder could find was as a subcontractor for a small firm in Norman, Okla., which served individuals and small nonpublic companies, and some of those clients refused his services after the jury verdict. Despite Judge Ellison's previously expressed views about the evidence and the realities of Mr. Snyder's personal circumstances, at the remedy phase, the SEC asked for all possible remedies: an injunction against future securities violations, a bar upon future

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service as an officer or director, civil penalties, and disgorgement. Judge Ellison denied all but the disgorgement remedy.

Enforcement Remedies

• **Enforcement Remedies Not Automatically Imposed.** In denying the SEC's other requested remedies, the court rejected several of the SEC's arguments that appeared to presume that such remedies were virtually automatic in cases involving fraudulent financial reporting. Instead, the court demanded a particularized showing that the requested remedies were necessary in this case. Judge Ellison's analysis of the SEC's far-reaching arguments, even though made in the context of an obviously questionable case, highlights certain principles that merit consideration by other courts in SEC actions generally in striking a balance between deterrence and fairness, as well as by the SEC in formulating requested remedies.

'Egregious' Reporting

• **Not Every Fraudulent Reporting Violation Is "Egregious."** Courts considering a permanent injunction, an officer/director bar, or a civil penalty must determine whether the defendant's violation was "egregious." In claiming that Mr. Snyder's violation was egregious, the SEC emphasized the importance of accurate financial disclosure to the integrity of the financial markets, arguing that any false and misleading statement is "by its very nature" an egregious act.

The court rejected this argument, noting that although accurate disclosure is "of critical importance to financial markets," this does not "inevitably mean that every violation is necessarily egregious." If accepted, the SEC's argument "would render it unnecessary for a court ever to undertake an inquiry of egregiousness in cases involving fraudulent reporting violations." *Id.* at 3-4. Thus, the court rejected the SEC's position that the "egregiousness" factor automatically weighs in its favor.

• **A Jury Verdict Does Not Foreclose Consideration of Other Evidence of Scienter.** Another factor in determining the proper remedies to impose is the defendant's degree of scienter. The SEC argued that the jury found the requisite scienter, and accordingly the court was bound by that verdict. The court rejected the SEC's contention that a jury verdict regarding scienter forecloses the court from considering—at the remedy stage—evidence showing that the violation may not have been obvious to the defendant. As the court pointed out, "the jury's verdict of liability does not mean that the jury rejected this [exculpatory] evidence wholesale; however, it does mean that the jury was more persuaded by the SEC's evidence of scienter." *Id.* at 8. Although the *Snyder* court ultimately found that it should give "due respect" to the jury's findings regarding scienter, the court recognized it could consider

evidence favorable to the defendant in assessing the weight given to the scienter factor.

• **Recognition of Wrongfulness Does Not Require a Surrender of Appellate Rights.** Whether a defendant recognizes the wrongfulness of his conduct is another factor relevant to whether a court should enter an injunction or an officer/director bar. The SEC argued that Mr. Snyder had failed to demonstrate such a recognition because he continued to maintain his innocence, despite the jury verdict. As the court noted, "the kind of admission the SEC seeks would eliminate all of Defendant's appellate rights." The court believed that Mr. Snyder should not be forced to make the Hobson's choice between preserving his right to appeal and obtaining the proper remedy. The court held that where evidence provides "some reasonable basis for Defendant's maintenance of his innocence," and where the defendant shows that he understands the importance of the securities laws, the fact that a defendant maintains his innocence gives support to the imposition of these remedies that is "minimal at best." *Id.* at 9. While the "recognition of wrongfulness" factor will favor a defendant who is contrite, it does not necessarily weigh heavily against a defendant who preserves his appellate rights.

• **Circumstances Rendering Remedies Unnecessary.** When considering an injunction or an officer/director bar, the court is also called upon to predict whether the defendant is likely to violate the securities laws in the future. One obvious factor in that analysis is whether the defendant will have "opportunities for future violation." In this context, the SEC made two arguments that the *Snyder* court did not directly address, but which merit mention here. First, the SEC argued that Mr. Snyder's "strenuous opposition to an officer/director bar demonstrates an intent to seek such an officer or director position in the future." Second, the SEC pointed to evidence of Mr. Snyder's good character as an indication that someone might allow him to hold a sensitive corporate position in the future. *Id.* at 14.

Neither argument was addressed specifically because the court was persuaded that it was extremely unlikely that Mr. Snyder would ever again hold a management position in a public company. This consideration led the court to deny an injunction and an officer/director bar: practical realities rendered these remedies unnecessary. The court evidently recognized that the reality for most defendants, is that, a finding of liability for a federal securities law violation, is a death sentence from a career standpoint. Indeed, the court rebuked the SEC for making arguments that "trivialize the devastating effects that Defendant has suffered

on account of this litigation." *Id.* at 20.

It is unfortunate that the *Snyder* court never squarely addressed the SEC's arguments that opposition to the SEC's request for an officer/director bar, or evidence of good character, weigh in favor of an officer/director bar. A defendant obviously should not be punished for being of good character, nor should a court draw a negative inference against a defendant for merely opposing remedies sought by the SEC.

Common Sense Approach

The remedies analysis in *Snyder* is commendable. Despite the liability findings of the jury, the court did not wholesale adopt the SEC's demands for relief despite the SEC's arguments that all available remedies are appropriate—even mandatory—after a liability finding. Instead, the court insisted that the remedies be tailored to the individual circumstances and also did not agree to penalize the defendant for not capitulating. Perhaps this decision, and others in which the courts are tempering the SEC's uniform remedies demands, will encourage the SEC to take a closer look at its remedies demands in the context of pretrial settlements by, considering all the facts, including the degree of a defendant's culpability, before demanding the full panoply of available remedies in every case. Assistance from the courts, as Judge Ellison's thoughtful decision provided, is welcome and necessary in a situation where a putative defendant has no bargaining power.

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1. 15 USC §78u(d)(1) (SEC may seek injunction against a person who is "engaged or about to engage" in securities law violations).

2. 15 USC §78u(d)(2) (court may impose an officer/director bar if the person's securities law violations "demonstrates unfitness to serve as an officer or director" of a public company).

3. *S.E.C. v. Patel*, 61 F.3d 137, 139 (2d Cir. 1995) ("In the exercise of its equity powers, a district court may order the disgorgement of profits acquired through securities fraud.")

4. 15 USC §§78u(d)(3)(A) and 77t(d)(1).

5. *Id.*, 2006 WL 1806164 (S.D. Tex. June 29, 2006) (Rule 50 motion opinion)

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