Mark Cuban Escapes SEC Shark Tank, But Will You?

Despite two recent trial victories by individuals (including Mark Cuban) against the SEC, Chair Mary Jo White has made it clear that the SEC will continue to aggressively pursue individuals and perhaps take even more cases to trial.

"So in this age of diminishing trials, we at the SEC may be about to reverse the trend a bit."
—SEC Chair Mary Jo White

In a late September speech, Chair White stated, "Another core principle of any strong enforcement program is to pursue responsible individuals wherever possible. That is something our enforcement division has always done and will continue to do. . . I want to be sure we are looking first at the individual conduct and working out to the entity, rather than starting with the entity as a whole and working in." The SEC's commitment to using its full arsenal of legal theories to reach individuals is reflected in the failure to supervise action instituted by the Division of Enforcement this past summer against Steven Cohen, the founder and owner of S.A.C. Capital.

Then, in a mid-November speech, after citing statistics about the substantial decline in the number of trials in the United States, Chair White described the importance of trials to the development of the law and to public accountability for defendants and the Commission alike, and concluded, "So in this age of diminishing trials, we at the SEC may be about to reverse the trend a bit." Chair White further noted that the SEC's new policy of requiring settling parties to make admissions in certain cases may also drive an increase in the number of trials.

Chair White's public statements are noteworthy because they indicate that the SEC is not going to let an occasional loss prevent it from pursuing difficult cases it believes need to be brought to protect the investing public. Her statements also reflect her belief that the SEC trial lawyers "are incredibly skilled and effective." Ironically, the SEC's policy of litigating more cases may find support from the unlikeliest of sources — the very companies that are the subject of SEC enforcement investigations.

To be sure, there remain compelling reasons why companies, particularly regulated entities, should settle an SEC investigation rather than face even a low probability of a high-risk outcome at trial. Yet the litigation option may be increasingly attractive in light of harsher settlement demands. These include admissions of wrongdoing and the attendant risk of lost business and collateral civil liability, a ratcheting-up of the frequency of fines measured in the hundreds of millions of dollars and more, and the multiplier effect on sanctions when, as is increasingly the case, multiple regulators investigate the same conduct.

These increasing costs of settlement, combined with the SEC's pro-litigation posture, make it more critical than ever to prepare for trial from the outset of an inves-

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tigation. Not only might a trial bring victory, or a loss that compares favorably to the cost of settlement, but companies with legitimate defenses that are prepared to litigate will have an increased chance of obtaining a more favorable settlement outcome. Of course, conducting your business in a way that attracts the least amount of attention from regulators in the first place is always the best alternative.

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Recent SEC Trial Losses

The SEC lost a widely-followed trial on October 16, 2013, when a federal jury in Dallas rejected the Commission's claims that Mark Cuban, the wealthy and outspoken owner of the Dallas Mavericks and reality TV star, violated insider trading laws when he sold his stake in Mamma.com after receiving confidential non-public information. Nearly two weeks later, on October 29, 2013, the Commission suffered another — albeit less newsworthy — defeat when the Chief Administrative Law Judge denied all claims against two senior officials at UBS Financial Services Inc. of Puerto Rico (UBS PR).

The Cuban Verdict

The SEC filed its complaint against Cuban in 2008, alleging that, despite agreeing to keep material non-public information about an impending PIPE offering by Mamma.com Inc. confidential, Cuban sold all of his holdings — 600,000 shares or 6.3% stake — in the company, thereby avoiding more than $750,000 in losses. This information allegedly was transmitted to Cuban during a call with Guy Faure, the former CEO of Mamma.com.

The unrecorded phone call between Faure and Cuban became the trial's focal point. The SEC faced an uphill battle in this "he said, he said" scenario because it could not compel Faure, a Canadian citizen residing in Canada, to attend the trial. Accordingly, the SEC displayed Faure's recorded testimony on a TV screen. Cuban, on the other hand, provided live testimony, stating that he did not agree to keep the information confidential and not trade based on that information. After a two-week trial, the jurors determined in under five hours that the information Cuban acted on was not confidential and that he did not promise not to trade on it.

The UBS PR Matter

In *In the Matter of Miguel A. Ferrer and Carlos J. Ortiz*, the Division of Enforcement alleged that the respondents, both senior officials at UBS PR, misled thousands of customers into buying and holding hundreds of millions of dollars in UBS PR-affiliated, non-exchange-traded closed end funds (CEFs). The Division alleged that Ferrer and Ortiz touted the CEFs as safe and liquid, when in fact UBS PR was propping up the market through its own purchases. The Division alleged Ferrer and Ortiz made misstatements and omissions in multiple settings, including in a newspaper interview, and in emails, memos and presentations to UBS financial advisers.

Following a 13-day trial, Chief Administrative Law Judge Murray, in an Initial Decision dated October 29, 2013, concluded that the Division had not shown by a preponderance of the evidence that Ferrer or Ortiz made misrepresentations or omissions to customers in the particular instances alleged. ALJ Murray provided several bases for her conclusions, including that Ferrer's statements to the newspaper were about mutual funds in Puerto Rico in general, and not about the particular UBS PR funds. ALJ Murray further determined that Ferrer's emails and memos at issue consisted of just a few lines and were not meant to be a full blown analysis of the benefits and risks of owning the CEF shares. Additionally, in finding that one of Ortiz's presentations was accurate, ALJ Murray stated that it was significant that the financial advisers had much of the information that Ortiz had.

As a result of the SEC's approach, it is imperative that at the inception of an investigation, prospective defendants anticipate a Hobson's choice — settlement with severe sanctions (including a possible admission) or trial.

Avoiding the Hobson's Choice

It would be a mistake to take away from these two very different matters that going forward the SEC will hesitate to bring difficult actions. Individuals who engage in wrongdoing, irrespective of the severity of the misconduct or their position, should take little solace and avoid extrapolating larger themes from these decisions. Rather, it is likely that SEC enforcement attorneys will view these trial results as a function of particularities of those trials. For example, they may believe that, given his prominence and notoriety in the Dallas community, Mark Cuban benefited from a favorable jury pool. Moreover, they may believe that this case was particularly difficult because it boiled down to testimony regarding a brief telephone conversation involving an unavailable witness.

Additionally, it is reasonable to expect that the SEC, which has many talented attorneys, will learn from its experiences. Post-mortem evaluations of trials are the norm, and lessons learned are applied in future trials. Moreover, the Commission's determination to take a case to trial demonstrates its belief that it has the evidence to prove its case. Finally, the SEC has an overall strong trial record. In fact, since the Cuban verdict in mid-October, the SEC has had three trial victories without a defeat. What is clear is that the Commission will not be deterred from pursuing cases to trial. Crediting recent indications from the Commission, trials will remain an important weapon in the SEC's arsenal.

As a result of the SEC's approach, it is imperative that at the inception of an investigation, prospective defendants anticipate a Hobson's choice — settlement with severe sanctions (including a possible admission) or trial. Given this choice, prospective defendants must place greater emphasis on preparing for trial from the commencement of an investigation. Since the SEC is no more immune to litigation risk than any other party, being fully prepared may help to reduce the severity of settlement terms, diminish the likelihood of trial, and increase the likelihood of a victory if a trial is unavoidable.

But staying out of the SEC shark tank remains the preferable course. Companies must integrate a risk-based, properly resourced compliance program into their busi-

ness operations, one that management embraces through word and action and that constantly adjusts to account for experience, emerging business risks and regulatory priorities. Companies that adopt this approach not only increase the odds of preventing violations in the first place, but are well-positioned to legitimately claim to the SEC that misconduct that occurs despite a strong control environment is best understood as aberrational or roguish behavior for which the entity should not be held responsible.

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