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SEC Defense Lawyers Well-Advised to Consider Criminal Exposure Early On

In the new era of cooperation between the Securities and Exchange Commission and criminal prosecutors, SEC defense lawyers should consider the possibility of criminal exposure from the outset, New York lawyer Mauro M. Wolfe, Duane Morris LLP, told BNA in a Feb. 22 interview.

He also suggested that to the extent a practitioner is not comfortable in the criminal arena, he or she should get criminal defense counsel involved early in the investigation. While prosecutors once were unlikely to pursue smaller Ponzi scams or routine pump-and-dump violations, Wolfe cautioned, ''in today's world, I think most prosecutors would be interested.''

Wiretap Evidence. Wolfe made his remarks against the background of a parallel proceeding in which a dispute over the SEC's right to the Justice Department's wiretap evidence has highlighted constitutional and other tensions inherent in the dual enforcement process. In the controversy, Galleon Management LP principal Raj Rajaratnam and other defendants are facing SEC and related DOJ charges in what authorities have called the largest hedge fund insider trading case in U.S. history (41 SRLR 1937, 10/26/09).

While the SEC obtained the wiretap evidence in the Galleon case indirectly through the civil discovery process, Wolfe said practitioners are—or should be—concerned that wiretaps and other tools currently available only in criminal proceedings could be used in other civil cases. ''If you can use wiretap evidence in insider trading cases, why can't you justify using it for accounting fraud or Ponzi schemes, etc.?''

''So in terms of parallel investigations, that changes the landscape,'' Wolfe continued. He said that with the SEC and the U.S. Attorneys' Offices working closely together, ''when you get wind of an investigation, you have to think about the use of wiretaps, about how long the criminal investigation has been going on. . . . The ratcheting up of criminal authorities' use of these tools means that SEC defense attorneys will have to consider criminal exposure early on.''

Joint Investigations. As illustrated by *Galleon* and an earlier case, *United States v. Stringer*, which addressed the SEC's obligation to inform an enforcement target of any parallel DOJ investigation, information-sharing between the SEC and DOJ can give rise to constitutional questions. Given the agencies' differing mandates, how, in practical terms, do they conduct a so-called joint investigation?

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''It's tricky in the sense that both the SEC and the DOJ have to remain disciplined and vigilant about their independent duties and roles,'' Wolfe responded, ''but it's manageable.'' He noted that under Fed.R.Crim.P. 6(e), prosecutors may not disclose information obtained through the grand jury process. One way of dealing

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with that, he said, is to allow the SEC more lead time to conduct its investigation. On occasion, DOJ may ask the SEC to take the lead in an investigation, especially in complicated investment products or strategies cases where prosecutors may lack specific expertise. Another way is for DOJ to share information not obtained via grand jury proceedings.

According to Wolfe, the difficulty arises when DOJ obtains highly relevant information that it cannot share—the wiretaps in *Galleon*, for example. At the SEC, when prosecutors ''start talking to you [the SEC] less and less, . . . you realize something's going on, but you can't inquire about it.''

From time to time, Wolfe continued, criminal authorities may seek to have an SEC lawyer with expertise in a certain area ''jump over the wall'' and become a member of the criminal enforcement team. However, he noted, when an SEC staffer goes ''over the wall'' to become a Special Assistant U.S. Attorney, that person is precluded from sharing grand jury information with the commission, even when the staffer works out of his or her SEC office.

Biography.

Mauro M. Wolfe is a partner at Duane Morris LLP, New York. He practices in the area of litigation, with a focus on white-collar criminal defense, securities enforcement and regulation, internal corporate investigations, and data security and privacy matters.

Before joining Duane Morris, Wolfe was a prosecutor in the U.S. Attorney's Office for the District of New Jersey, where he worked in the Securities and Healthcare Fraud Unit. Earlier in his career, Wolfe served as a senior enforcement attorney in the SEC's Philadelphia District Office and as an assistant district attorney in the Philadelphia District Attorney's Office, Narcotics Division. He is a board member of Latino Justice PRLDEF. Wolfe is a graduate of Temple University Beasley School of Law and Indiana University of Pennsylvania.

Form 1662. When representing a defendant in an SEC civil action, Wolfe said lawyers should take a close look at the case for potential criminal issues. ''Certain kinds of cases one should almost presume will garner the interest of criminal prosecutors—lots of investors, lots of money, Ponzi schemes, insider trading—cases that are easily colorable as theft.''

Large accounting cases also may pique DOJ's interest, as may cases that receive a great deal of press coverage. Both the SEC and DOJ are under a great deal of public scrutiny, Wolfe said, especially the SEC in the post-Madoff era.

Asking the SEC directly whether there is a criminal investigation might aid in the analysis, he continued. Historically, however—''and in most SEC offices in the Northeast''—the commission takes a very conservative position and declines to confirm or deny the existence of a criminal investigation.

More likely, Wolfe related, the agency will refer defense counsel to Form 1662, the form at issue in the *Stringer* case, which cites the possibility that information received in the course of the civil investigation could be made available to federal prosecutors. ''That doesn't tell you whether there is or isn't an investigation.''

On the other hand, Wolfe continued, other SEC offices outside the northeast region ''may be more open'' to disclosing the existence of a criminal investigation, and in some cases, DOJ may authorize the SEC to reveal the criminal probe. However, in other cases, as in *Stringer*, DOJ may wish to remain hidden as the SEC conducts its investigation.

Taking the Fifth. Second, Wolfe suggested, in cases with a strong likelihood of criminal consequences, SEC defense attorneys should get criminal defense lawyers involved early in the investigation, rather than waiting until DOJ or the FBI knocks on the door. Lawyers also should consider advising their client to assert the Fifth Amendment if the case is of a type that interests criminal law enforcement.

In fact, Wolfe said, one error ''rampant'' among SEC defense counsel is allowing the client to testify without fully considering the criminal exposure. ''That's the number one area I would be concerned about. There's so much risk in having clients testify before the SEC. . . . When you testify, the SEC can pick and choose portions of the testimony. It's very difficult sometimes to overcome that.''

In SEC cases involving a private company, Wolfe continued, it may be in the best interests of the corporate officer to take the Fifth because the board of the privately held company may be less inclined, compared to a public corporation, to terminate the official, at least until charges are filed. In other circumstances, however, assertion of the privilege can have ''an almost immediate effect on the employee-employer relationship.''

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''It's more difficult for an officer, director, or employee of a large publicly traded company to assert the Fifth and expect to keep his job,'' Wolfe explained. ''The same analysis applies to a registered representative of a large financial services company. My experience has been that the registered rep will be summarily fired. . . . You have to find a balance of personal employment interest against criminal exposure, and do it very carefully,'' Wolfe advised.

Nonetheless, Wolfe acknowledged, in any investigation, deciding whether to plead the Fifth is a difficult process. On the one hand, doing so carries employment risks and the possibility of an adverse inference. On the other hand, an innocent individual who opts to testify risks making a misstatement that will result in a problem down the road. A lawyer should have a clear understanding of all of the facts, as well as the potential consequences of each course of action, before making a recommendation, Wolfe stated. He added that any cli-

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ent who decides to testify should be very well prepared by counsel.

Internal Controls Group. While job termination is not an issue when the client is a corporation, that scenario can present other issues, Wolfe continued. For example, he said, the identity of the company's internal control group—generally, the group of individuals that tells the lawyer what to do—''needs to be clarified early on.'' However, this becomes problematic when, for example, a member of the control group is the entity's chief executive officer who also is the subject of a criminal investigation.

Such circumstances raise the concern that the CEO will act in his or her own best interest rather than the company's, or even interfere with or obstruct the investigation. ''It doesn't always happen,'' Wolfe said, ''but that's an issue that makes the process more difficult. So get a board resolution identifying independent board members if possible.''

Doing so, however, may entail a difficult discussion when, for example, the CEO or the majority shareholder is both the target and the control person. In other cases, however, the CEO may decide not to be a control group member. ''Sometimes [DOJ] takes a position that the CEO or the CFO is a bad actor'' who should not be part of the control group, or even remain in his or her position.

''There are no hard and fast right answers,'' Wolfe concluded. While some prosecutors may object to an officer who is the ''target'' of the investigation continuing to have a role controlling the company, DOJ technically has no formal role in the issue. Nonetheless, he said, prosecutors may seek to persuade the company to discharge the official. ''This is a very difficult process for both the government and the individual defense counsel for the officer and the defense counsel for the company. It is a very delicate dance.''

''These are challenging situations,'' Wolfe summed up, ''but you have to figure out ways as a practical matter to work with the company and work with law enforcement'' in the best interests of the company.

Cooperation Policy. Asked how the SEC's cooperation policy factors into the scenario, Wolfe said it remains to be seen how the agency wants to proceed—''and what, if anything, they're willing to do to work with DOJ.''

''For individuals,'' he continued, ''my sense is that it [the cooperation policy] may not have the desired effect.'' He said if he were a lawyer with a client who had material information about a fraud, or even participated in a fraud, ''I am not sure I would be too worried about cutting a deal with the SEC right away. The 800 pound gorilla really is the DOJ.'' On the other hand, a defense lawyer with a corporate client that wants to cut a deal, ''will likely run to DOJ first.''

Cooperation has become an important issue in the Foreign Corrupt Practices Act arena, Wolfe noted, saying the bar is still looking for some indication from regulators of the level of benefit a corporation can obtain by cooperating. ''Companies that spend millions and millions of dollars . . . developing anti-corruption programs would like to be treated differently than corporations that make no effort at all.''

Such entities, Wolfe explained, ''in nearly every instance . . . will also cooperate with law enforcement. There really is no incentive to spend that kind of money and not cooperate.'' As yet, however, there is no ''formal structure'' in place.

''From a defense perspective,'' he added, ''corporate clients want assurances that there is some benefit to having a compliance program. Otherwise, . . . what incentive do companies have to create these expensive programs, other than the intrinsic value of being a good corporate citizen?''

While law enforcement is starting to recognize this important factor, he added, there is data in the FCPA arena suggesting that settlements are not reflecting the benefit of having a strong compliance program in terms of reduced penalties and fines. ''We are still watching settlements very closely.''

Filtering Program. Asked whether the SEC's budget constraints are a factor in referring cases to criminal prosecutors, Wolfe posited that the agency is unlikely to bypass a significant or meaningful prosecution for lack of resources. Rather, he suggested, the ''real question'' is whether the agency will be able to investigate all of the cases in which they receive a referral or investor complaint—especially given the flood of information likely to result from its new whistleblower bounty program.

''The 800-pound gorilla really is the DOJ.''

The SEC will have to have a ''filtering program'' to handle those inquiries, Wolfe said. If the commission's limited resources lead to a ''gap'' in its ability to conduct investigations, it is possible that state attorneys general may step in to fill the void.

Finally, Wolfe observed that SEC Enforcement Director Robert Khuzami comes from a strong prosecutorial background, which he said ''can only help the cooperation between the SEC and DOJ.''

Khuzami ''knows criminal prosecutors, . . . he speaks their language.'' His leadership of the division has been an ''immense help'' to the parallel investigation process.

BY PHYLLIS DIAMOND