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Litigation and Enforcement in the C-Suite

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Litigation and Enforcement in the C-Suite

This past year witnessed a number of significant litigation and enforcement developments that directly impact corporate officers. From new government guidance on enforcement priorities to notable rulings in private securities suits, these developments further defined officers' individual exposure and merit officers' and their counsel's careful scrutiny when assessing litigation risks.

Throughout the past year, the SEC emphasized its intent to pursue enforcement actions against individual officers and directors. The agency highlighted gatekeepers—those who are in a position to ensure that financial statements and disclosures are accurate and that company compliance programs are adequate—as a particular focus for enforcement. Andrew Ceresney, Director of the SEC's Division of Enforcement, recently stated:

> A common thread throughout the [Division's enforcement] priority areas . . . is an emphasis on the importance of gatekeepers to our financial system: attorneys, accountants, fund directors, board members, transfer agents, broker-dealers, and other industry professionals who play a critical role in the functioning of the securities industry. Gatekeepers are integral to protecting investors in our financial system because they are best positioned to detect and prevent the compliance breakdowns and fraudulent schemes that cause investor harm. When gatekeepers fail to live up to their responsibilities, the Division has held—and will continue to hold—them accountable.

Oversight of the SEC's Division of Enforcement: Hearing Before the Subcomm. on Capital Mkts. and Gov't Sponsored Enters. of the H. Comm. on Fin. Servs., 114th Cong. 7 (2015) (statement of Andrew Ceresney, Dir., Div. of Enforcement, SEC).

The agency's 2015 enforcement results confirmed that it did indeed focus on gatekeepers, identifying a number of significant cases in which the SEC held attorneys, accountants, auditors, and "other gatekeepers accountable for failures to comply with professional standards." Press Release, SEC, SEC Announces Enforcement Results for FY 2015 (Oct. 22, 2015), http://www.sec.gov/news/pressrelease/2015-245.html.

The Department of Justice manifested a similar intent to hold individuals accountable for corporate wrongdoing when it issued the Yates Memo in September 2015. The memo emphasizes that "[o]ne of the most effective ways to combat corporate misconduct is by seeking accountability from the individuals who perpetrated the wrongdoing." Recognizing that there are significant challenges inherent in pursuing individuals in cases of corporate misdeeds, the memo outlines six steps that government attorneys should follow "in any investigation of corporate misconduct" in order to "hold to account the individuals responsible for illegal corporate conduct":

(1) To be eligible for *any* cooperation credit, corporations must provide to the Department all relevant facts about the individuals involved in corporate misconduct.

(2) Both criminal and civil corporate investigations should focus on individuals from the inception of the investigation.

(3) Criminal and civil attorneys handling corporate investigations should be in routine communication with one another.

(4) Absent extraordinary circumstances, no corporate resolution will provide protection from criminal or civil liability for any individuals.

(5) Corporate cases should not be resolved without a clear plan to resolve related individual cases before the statute of limitations expires and declinations as to individuals in such cases must be memorialized.

(6) Civil attorneys should consistently focus on individuals as well as the company and evaluate whether to bring suit against an individual based on considerations beyond the individual's ability to pay.

Courts also issued a number of important rulings in 2015 that will bear on officers' potential litigation exposure. The most notable was the Supreme Court's decision in *Omnicare, Inc. v. Laborers District Council Construction Industry Pension Fund*, in which the Court outlined the factors for determining whether a statement of opinion constitutes a material misstatement or omission under § 11 of the Securities Act of 1933. A number of lower courts have already grappled with this holding, and, in a few cases, courts have upheld plaintiffs' claims against officers or directors based on statements of belief contained in public filings. Another notable theme in court rulings involved the application of the Supreme Court's ruling in *Janus Capital Group, Inc. v. First Derivative Traders* to officers and directors. For instance, the Seventh Circuit recently suggested that an executive must actually exercise control, rather than just have authority to exercise control, over the content of a press release in order to be a "maker" of a false statement contained in the release under Rule 10b-5. Finally, the Supreme Court denied certiorari in *U.S. v. Newman*, an insider trading case in which the Second Circuit overturned convictions of two hedge fund managers on the grounds that the government had submitted insufficient evidence to show that the alleged tippers received a personal benefit in exchange for their tips or that the alleged tippees knew that the tippers received such a benefit. Significantly, the Second Circuit held that a personal benefit must be "of some consequence," and could not be inferred from "the mere fact of a friendship, particularly of a casual or social nature."

Following are summaries of notable cases and enforcement actions from the past year brought against corporate officers.