CALIFORNIA LAWYER

Roundtable Series

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SECURITIES

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Roundtable Series

Securities

Changes are afoot in the securities landscape. Vows to roll back Dodd-Frank and a top brass makeover at the Securities and Exchange Commission may signal a new era of reduced regulation. But at this early stage, what trajectory securities regulation and enforcement will take under the Trump administration remains to be seen. For now, practitioners are watching, carefully, as the president's agenda and appointments take shape.

On the litigation front, the U.S. Supreme Court issued a unanimous decision in the insider trading case *Salman v. United States*. The Court also granted certiorari to resolve a circuit split on the statute of limitations for SEC disgorgement claims, and it may weigh in on state courts' jurisdiction over Securities Act claims.

Meanwhile, the Delaware Chancery Court's decision in *In re Trulia Shareholder Litigation* is making waves in M&A litigation, sparking a lively discussion on judicial scrutiny of "disclosure-only" settlements. Our panel explored these issues as well as securities trends on the horizon in 2017.

California Lawyer met for an update with Jordan Eth of Morrison & Foerster; Joshua D.N. Hess and Matthew L. Larrabee of Dechert; and Lloyd Winawer of Goodwin.

Participants

JORDAN ETH
Morrison & Foerster

JOSHUA D.N. HESS
Dechert LLP

MATTHEW L. LARRABEE
Dechert LLP

LLOYD WINAWER
Goodwin

Moderated by
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DISCUSSION

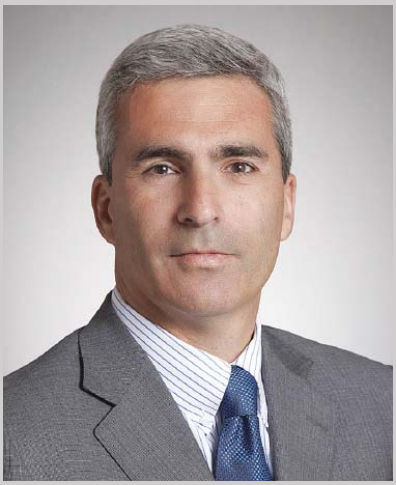
MODERATOR: Wall Street lawyer W. Jay Clayton has been nominated to head the SEC. There are also two commissioner vacancies. Do you anticipate seeing a shift in securities regulation and enforcement in the Trump administration?

JOSHUA D.N. HESS: It is easy to say that there's going to be a vast sea change in the Trump administration by comparison to the Obama administration, given the rhetoric and the actions of the administration. That said, many of these issues are not going to be within the realm of the SEC to accomplish unilaterally, even if they want to, particularly with respect to issues that revolve around Dodd-Frank. They will require congressional action, which is hard to predict, even with a Republican Congress.

Also, the existing enforcement mechanism is not going anywhere. There will be definitive changes in focus and magnitude of enforcement, but I do not anticipate a sea change. Instead, it will be a reduction at the margins. Also, I don't think we are going to see broken windows enforcement that we have been seeing under Mary Jo White. We will return to Obama first term, G.W. Bush second term level of enforcement.

Enforcement is not going away. It is going to largely focus on the same things it has. Though, perhaps at least in the short-term, you'll see less of the small broken windows type of enforcement we have been seeing.

JORDAN ETH: So just to make this



JORDAN ETH, a partner in Morrison & Foerster's San Francisco office, co-chairs the firm's securities litigation, enforcement, and white-collar defense group. He specializes in representing public companies and their officers and directors in securities class actions, SEC investigations, derivative suits, and internal investigations. In 2008, he received a California Lawyer Attorney of the Year award for his co-leadership of the successful defense of JDS Uniphase and its former executives in a securities class action jury trial.

jeth@mofo.com

mofo.com

interesting, I'll take an opposing view: It is going to be quite different. The idea that Trump is not going to be all that different has been disproven a thousand times in the last few months.

Now, exactly *how* it will be quite different is up for grabs. For starters, you can take a look at who is going to be in charge: Wall Street attorney Jay Clayton instead of a former prosecutor—that's very different. Also, follow the money: will the SEC receive more resources under the Trump administration? I highly doubt it. We'll see soon enough.

If we look at what they are going to be enforcing, you can look at Jeb Hensarling's CHOICE Act which would likely eliminate the administrative procedures that the SEC has been using. So any of the exotic social warrior-type things will be gone. Just recently they got rid of the conflict minerals rule. Already the acting head of the SEC said that the offices can no longer open a formal matter themselves; they have taken away that delegated authority and brought it back to Washington.

So when we have a group of people who want to "make America great again," I don't think their idea is going back to Obama first term or G.W. Bush second term. It is going back to a decade before expansive enforcement and before the modern—meaning last ten years—change in the SEC as more of a prosecutorial agency.

There will be enforcement against penny stock fraud, boiler rooms, and elder abuse, but the more sophisticated work will probably be much less in quantity. Of course, we are talking about Trump, so anything can happen, even in the next few weeks.

LLOYD WINAWER: The nomination of Jay Clayton, an M&A and capital markets transactional lawyer, certainly brings a different perspective than Mary Jo White. The pervading sentiment is that he will bring an increased emphasis on capital formation and related regulatory processes and, as Josh [Hess] said, perhaps a lighter touch in certain enforcement areas. That remains to be seen. There are many questions right now.

As noted, there presently are two commissioner vacancies and Commissioner Stein's seat comes up in 2017. We also have to see who will head Enforcement and which specific areas will be prioritized.

On the regulatory side, President Trump's comments suggest there will be a lot of activity. He had very harsh words for Dodd-Frank both during the campaign and since the election, calling it a "disaster" and vowing to "dismantle" it.

Those comments have been echoed by Treasury Secretary Steven Mnuchin as well as by Gary Cohn, Director of the National Economic Council.

Let's not forget, however, that Congress funds the SEC. Just how successful and how far President Trump will be able to push his stated deregulation agenda remains to be seen even with a Republican-controlled Congress. Ultimately, I expect some revision to Dodd-Frank but not anything approaching a dismantling.

MATTHEW L. LARRABEE: I think we can all agree that right now, there is a tremendous amount of uncertainty. We also know pretty clearly what the Trump administration's goals are because they state them in the bluntest, most direct language imaginable.

But how far are they going to get? I think as a policy matter, we will see aggressive deregulation policies and aggressive goals to dismantle and repeal Dodd-Frank. What gets put in its place is absolutely unknown to us because it is absolutely unknown to the Trump administration. It is not like they are hiding the actual answer. They don't know what it is. So that's a tempering factor.

There is no president who has been elected from either party who has not been frustrated by their inability to cut back on the bureaucracy. It is inconceivable that Trump will be the first president who wasn't frustrated by that.

If you talk to people that are in-line day-to-day SEC enforcement lawyers right now, their caseload is by and large the same, their personal individual goals are the same. The cases they are working on or planning to bring are the same as they were before the election. So at that level, whatever change is coming has not penetrated yet. So we'll have to see.

MODERATOR: Neil M. Gorsuch, a judge on the U.S. Court of Appeals for the Tenth Circuit, has been nominated to succeed the late Justice Scalia on the U.S. Supreme Court. If he is confirmed, do you anticipate greater scrutiny of securities claims?

WINAWER: If you look at Judge Gorsuch's background, he's not someone that plaintiff's lawyers can be terribly excited about. Going back to his time in private practice, he filed an amicus brief on behalf of the Chamber of Commerce in *Dura Pharmaceuticals v. Broudo*, 544 U.S. 336 (2005), criticizing the plaintiff's bar for seeking a "free ride to fast riches," and emphasizing the enormous toll that securities class actions impose on the business community—very similar views as those that prompted the PSLRA and SLUSA.

His opinion in *MHC Mut. Conversion Fund v. Sandler O'Neill & Partners*, 761 F.3d 1109 (10th Cir. 2014), stringently construed the Securities Act's text. The language in that opinion is strikingly similar to that typically seen in defendants' motions to dismiss briefs and his track record certainly suggests a conservative approach to securities cases.

LARRABEE: I agree with that. Gorsuch was actually on the panel in a securities case I had in the Tenth Circuit. The district court granted class certification and we sought 23(f) review. Gorsuch was on the panel which summarily reversed the lower court's opinion. I wouldn't say that there was much intellectual insight in his analysis, but it is certainly reflective of his willingness to take a defense perspective on securities law, particularly as it relates to class actions in supporting a ruling that's fairly unusual. How many times do we file 23(f) petitions and get them granted? My number is extremely small, most people's numbers are.

Sadly they remanded it back to the district court which issued a longer opinion saying essentially the same thing and another panel got it—one without Gorsuch—and we did not win the next time. It is hard to say whether he was the deciding difference, but that one experience, I think at least sheds some light on his perspective and how he might react to things. I agree with what's been said before: if you read what he's written, plaintiff's class action lawyers are probably not happy right now.

ETH: Yeah, if he's supposed to be the successor for Scalia, we can see what the trend was for Scalia, and it is to keep chipping away at it over time—and there's good reason for that as we have all written in briefs—but I think we are going to notice it especially because this is the 5-4 tipping point. What will the Court look like with Gorsuch on the bench versus Merrick Garland? It is 5-4 one way and 5-4 the other way.

I would be shocked if Gorsuch's confirmation leads to an expansive reading of securities laws. It will probably lead to cutbacks in lost causation and other areas where the courts are divided.

WINAWER: He recently wrote an unusual concurrence in *Gutierrez-Brizu-*

I would be shocked if Gorsuch's confirmation leads to an expansive reading of securities laws. It will probably lead to cutbacks in lost causation and other areas where the courts are divided.

– JORDAN ETH

JOSHUA D.N. HESS is a partner in the San Francisco office of Dechert LLP. Mr. Hess's practice focuses on white collar and securities litigation and antitrust matters, with a particular emphasis on internal investigations and the defense of class actions, shareholder litigation, and civil and criminal price-fixing cases. Mr. Hess has had broad experience in several of the largest securities and antitrust matters in the last few years.

joshua.hess@dechert.com

dechert.com

ela v. Lynch that was harshly critical of *Chevron* deference. Review of agency action and statutory interpretation is an area in which he appears to have keen interest.

HESS: Yeah, unlike Justice Scalia, who was an administrative lawyer by training and generally bought into *Chevron* deference, Judge Gorsuch is clearly striking at *Chevron* and favors a different path. For the SEC, going before the Supreme Court with a Justice Gorsuch as opposed to Justice Scalia would probably be harder for them.

MODERATOR: What impacts are you seeing from the Delaware Chancery Court's decision in *In re Trulia Inc. Shareholder Litigation*, 129 A.3d 887 (Del. Ch. 2016), which denied approval of a "disclosure-only" settlement of M&A litigation?

WINAWER: I can't help but be struck by the irony that in M&A litigation we have had plaintiffs recently leaving Chancery Court and filing cases in federal court, whereas here in California, as we are going to discuss shortly, plaintiffs are fleeing federal court for the perceived friendlier confines of state court. I don't think this will be a long-term trend, but we'll see.

For example, I expect federal district court judges to pick up on Judge Posner's recent decision in *In re Walgreen Co. Stockholder Litigation*, No. 15-3799 (7th Cir. Aug. 10, 2016), which referred to disclosure settlements as a "racket." Ultimately, as they become more experienced with these types of cases, which traditionally have been brought in Delaware, federal courts will become wise to forum shopping efforts and likely critical of these cases for the same reasons that they are now disfavored in Delaware.

ETH: The general principle is pretty simple: it is forum shopping. If you are a plaintiff's lawyer, you want to find a whole group of cases in a friendly forum so that you have something you can stamp out. You can file all your cases in that court, and they'll be successful because you have a track record, and it makes it less costly to do so.

What you see time and again is the pendulum swing where they'll find something that works, they'll overdo it, the courts or legislature will react, cut back on it, and then they have to go somewhere else.

In Delaware there was this huge amount of disclosure-only cases and it became something the courts realized was, as Posner said, a racket. So there was a reaction, and now they have to go somewhere else. It is the same thing that happened with securities laws back in the '90s.

I agree with Lloyd [Winawer], at some point judges in other jurisdictions will learn either through briefs or just through the sheer numbers of cases that something is going on. I don't think this is going to be a permanent trend of having deal cases in federal court.

LARRABEE: We are saying the same thing, but I think the change in the Delaware Court's perspective is permanent, not a trend. It is a fact, and it is not going to reverse. They will not go back to supporting disclosure-only settlements. So the question is where are the plaintiffs going to go?

I am glad to hear the optimism in the room on the efficiency of our federal judiciary system. That educational process could take years, depending on which courts they end up with. Our experience in front of federal district courts depending on where you are, is that they can be utterly unfamiliar with this process and tend to proceed in fairly traditional ways, which are fairly inefficient ways for deal

litigation. So it may take a while.

I agree that the one thing we know for a fact is that when it stops working in federal district court because the body of law and the experience of the judiciary improve, then something else is going to happen. So the ingenuity of man outpaces stare decisis.

HESS: Also, in line with *Corwin v. KKR Financial Holdings*, 125 A.3d 304 (Del. 2015), the Delaware Court has, in *In re Volcano Corp. Stockholder Litigation*, come out against merits claims that have typically been the source of these disclosure-only settlements as well. We are talking about the pendulum swinging, and these decisions show the Delaware courts have really swung hard against this type of M&A litigation. Delaware decided 94 percent of deals being challenged in their courts is too much, and that they are going to take control of that.

Now, after a period of time can the pendulum swing back and we see some modifications to *Volcano*? Maybe. For the reasons Matt [Larrabee] expressed, it's not clear that these cases are coming back to Delaware Chancery Courts.

But there is the state system. In most cases, that requires some sort of redomiciling, so that's a big deal. But New York state courts—knowing full well Judge Posner and Chancellor Bouchard's views on this—have decided they are going to be fine with these disclosure-only settlements. So those other forums exist beyond the federal system, and I agree with Matt [Larrabee] that I am not as optimistic that the federal system is going to copy Judge Posner on this very quickly. It might take a little time. Because no particular district will feel the abuse of that system the same way the Chancery Court will.

LARRABEE: The trick for the plaintiffs' lawyers is to figure out how to separate out the good claims from the bad claims and have enough left to support a business. That's what they are struggling with right now.

If you are a plaintiff's lawyer, the logical thing to do is to pick your cases carefully if they are going to be in Delaware. Maybe the disclosure claims are part of your case, but post-closing damages claims can be serious things. If you are a defendant in Delaware Chancery Court and you haven't done anything wrong, that's the court you want to be in. But if somebody's got a valid claim against you and you're in Delaware Chancery Court, it is not a bad place to be as a plaintiff.

WINAWER: At the end of the day, an important issue here is, what do companies want? One of the points Chancellor Bouchard made in *Trulia* is that the fundamental problem with disclosure settlements is the lack of an adversarial process. He pointed out that in this context, the adversarial process occurs in two settings, either in connection with a preliminary injunction motion or a mootness fee application.

For transaction participants, a preliminary injunction motion creates some uncertainty. Also, litigating those motions is expensive. It usually is cheaper to settle rather than litigate the action. Ultimately, many companies just want to get this over and done with and close the deal. Until that dynamic is somehow addressed—when it no longer is the economically rational decision to settle rather than fight—we are going to continue to have issues on this front.

LARRABEE: I agree. From a judicial perspective, it is hard not to criticize disclosure-only settlements if you are sitting on the bench. But for our clients, it's a predictable and modest "deal tax" versus the uncertainty of federal and state litigation or a post-closing damage claim. When you put truth serum to

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MATTHEW L. LARRABEE, a partner with Dechert in San Francisco and New York, has more than 25 years of experience in trial and appellate practice. He specializes in financial institutions litigation, securities and consumer class actions, antitrust cases, and other complex commercial litigation. His clients include major financial services, mutual fund, technology, and health care companies. Chambers USA, San Francisco Business Times, and the San Francisco Chronicle have named him a leading California litigator.

matthew.larrabee@dechert.com

dechert.com

your clients, they will take the disclosure-only settlement and a release getting the deal closed over an uncertain set of risks many times, if not most. So *Trulia* does not necessarily turn out to be a favor in the short-term or the mid-term for our clients.

ETH: It is an odd thing to do to call your clients and say, "The settlement was rejected. And the great thing is it is such a weak claim, we get to now win in court," but your client just wants out.

MODERATOR: Will the U.S. Supreme Court grant cert in *Cyan v. Beaver County Employees Retirement Fund*, No. 15-1439 (May 24, 2016), or *FireEye v. Super. Ct. of Cal.*, Case No. 16-1744 (Dec. 5, 2016), to address the phenomenon of Section 11 suits being filed in state court rather than federal court? What is the likely result?

ETH: The Supreme Court asked for the solicitor general's views in *Cyan*. George T. Conway III is reportedly being considered for the position. He happens to be a securities litigator at Wachtell, married to White House advisor Kellyanne Conway, a leader in the Federalist Society, and he's argued one case in front of the Supreme Court: the "f-cubed" case, *Morrison v. National Australia Bank Ltd.*, 561 U.S. 247 (2010).

So we don't have to guess at what his views are on securities cases. We have much more data on him than we do on Gorsuch. When the Court asks for the solicitor general's input, there's a very high likelihood, at least in securities cases, that it will be taken. So I can imagine if there's a new solicitor general who wants to get rid of this problem and writes a brief saying that, that the Supreme Court will take it, and then you'll have a really interesting decision.

It is odd because you would think that Republicans would be a little more states' rights-oriented, but this is still a federal statute. I actually think the correct reading is that state courts do not have jurisdiction over Section 11 class actions, only individual actions.

WINAWER: I think as Jordan [Eth] said, certainly the fact that the Court asked the Solicitor General to weigh in on the cert petitions definitely suggests an increased likelihood that cert will be granted. However, the fact remains that cert is granted in about 1 percent of the cases, and the plaintiffs here argue that there's no circuit split. We'll see.

This is an important issue which is crying out for resolution. According to the *Cyan* and *FireEye* cert petitions, since the *Luther v. Countrywide* decision came down in 2011, '33 Act class action filings in California have skyrocketed by 1400 percent. For comparison purposes, in the 12 years between the adoption of SLUSA in 1998 and *Luther*, there were six Section 11 class actions filed in state court. Since *Luther*, over the last five years there have been at least 38 such cases, and 14 filed in 2015 alone.

So this is a big issue. There is a reason why plaintiffs are filing these cases in state court as opposed to federal court. It's perceived by them—and the numbers would bear this out—as a much friendlier forum. For example, between 2011 and 2015, federal courts dismissed about 29 percent of Section 11 cases. Defending Section 11 cases raises challenges because it is a strict liability statute with no scienter requirement. But compared to the 29 percent federal dismissal rate, during the same period California courts have sustained demurrers in only two out of 25 Section 11 cases.

So there's a reason why plaintiffs are flocking to state court, and this is a key issue for companies headquartered in California.

HESS: I agree that there's almost no doubt that the solicitor general, whether it is George Conway or the acting solicitor general or whoever it may be is going to think that they should take this up and will support cert.

I think the Supreme Court will take it because notwithstanding no circuit split, the district courts are all over the place on this. There is vast disagreement everywhere except for in the Northern District of California. If the Court takes it, what is it going to do? It actually isn't all that clear. Let's say Gorsuch is, in fact, confirmed. Here you have a very intensely textual individual.

I think the same is true of Justice Alito and his opinion in *Salman v. United States*, 15-628 (Dec 6, 2016), indicates he's not totally plaintiff-unfriendly or SEC-unfriendly when it comes to securities laws. I agree entirely with Jordan [Eth] that it is clear that SLUSA suggests there is no jurisdiction of state courts for a Section 11 claim.

That said, it is clear that the anti-removal provision suggests that you cannot remove a case filed in the state court to federal court. So there's this total disconnect. The Supreme Court needs to look at what SLUSA was meant to do, which was to move these types of federal securities class actions away from federal court to state court. That is a legislative history argument that Justice Scalia hated and potentially Gorsuch and other justices who we generally consider defense-oriented may resist if they are looking at the text of the statute itself.

It will be very interesting. It is a very important case, particularly for companies that are in the tech and biotech industries that are doing IPOs. Those are the cases that tend to get hit in this area and end up in state court.

WINAWER: The rub for plaintiffs here is the first sentence of Section 22(a), which says state courts have concurrent jurisdiction "except as provided in Section 16 with respect to covered class actions." If that refers to the statutory definition of "covered class actions" game over, right? State courts then are not courts of "competent jurisdiction" and the removal bar later in Section 22(a) does not apply. Plaintiffs dispute this and have argued that only the category of cases precluded under Section 16(b) falls outside the removal bar. Ultimately the question is: what does this language mean?

It is ironic and an odd result for state class actions brought under state law to be precluded, but hold that state courts can be arbiters of federal law in securities class actions.

This point is emphasized in the *Cyan* and *FireEye* petitions; that it is a truly bizarre result and one that cannot be harmonized with SLUSA's objective of creating uniform standards.

ETH: To win this as a defendant in front of the new Supreme Court, you need a textual approach: Give me a couple hours, and I'll walk you through the statute, and here's why this is the only reading that makes sense.

HESS: If they make it up to the Supreme Court, the good news about *Cyan* and *FireEye* is that they are going to be a success for the defense bar regardless of the result. If we win, great. If we lose, this is a problem that Congress can very easily solve. I think everyone agrees that this is purely a drafting error. If the Supreme Court goes against *Cyan*, I think Congress will be motivated to fix it.

LARRABEE: Working this issue up their list of priorities may be hard. It is probably not going to be the number one thing for Congress, but it is an easy fix.

HESS: The Chamber of Commerce

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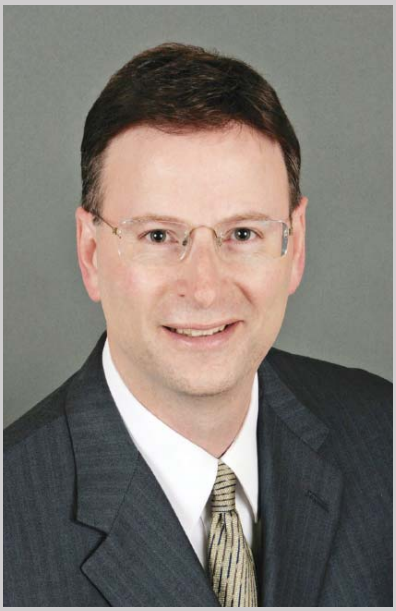

LLOYD WINAWER is a partner in Goodwin's Securities Litigation and White Collar Defense Groups. His work includes shareholder class actions, derivative lawsuits, M&A litigation, ERISA litigation, and SEC investigations and enforcement proceedings, claims for breach of contract, misrepresentation, violation of consumer protection statutes, unfair competition and other business torts. Mr. Winawer has represented corporations and individual clients in more than 50 shareholder class action and derivative cases in federal and state courts throughout the country.

lwinawer@goodwinlaw.com

goodwinlaw.com

and other entities that are going to be involved in this case if they choose them and have interest in this area will go to Congress and say, "We tried to fix this with SLUSA. There's a screw-up. Can you please add one little bit of language?" As long as the Republican Congress holds, then I think there's a decent shot of it being addressed.

WINAWER: On the legislative front, Paul Atkins, a former SEC commissioner who President Trump has appointed to lead the transition team's efforts on financial regulation, is reportedly looking closely at preemption of state blue sky laws. While this is not a preemption issue, per se, to the extent that you have state courts applying federal law in wildly divergent manners than federal judges, it certainly is a related issue. Whether there's anything to these rumors remains to be seen. But hopefully the Supreme Court will resolve the matter first.

MODERATOR: With that, let's move on to a few recent U.S. Supreme Court decisions. How will *Salman v. United States*, No. 15-628 (U.S. Dec. 6, 2016), impact insider trading cases? Do you consider it a narrow ruling?

ETH: *Really*, *really* narrow. It was about giving inside information to your brother who passes it on to someone else who you all know is going to trade and is married to your sister. It was written about as narrowly as these things can get in an area of the law that is crying out for clarity as it has been for 30 or 40 years. So I don't know if there will be a legislative solution to this or if it is just going to keep bumping along with courts deciding.

If it had gone the other way and said gift-giving isn't enough, you have to actually get a bag of money in an alleyway, now *that* would have been a big change. It seemed that the Court was intentionally avoiding anything controversial at all.

MODERATOR: Do you think they will address the issue more broadly later on, and perhaps they are just dipping their toes right now?

ETH: I think they are afraid of the water.

HESS: I agree. The Second Circuit's decision in *United States v. Newman* got people very excited for about nine months and the Supreme Court told them don't get excited. This case is not going to help anybody with clarifying what the elements of insider trading are. They took an incredibly narrow fact pattern where everybody was related to one another, and reaffirmed *Dirks*.

So basically we return to where we were before. I don't know if we will net any new guidance from the courts in this regard. It is unlikely we will get any legislative response to this at all either. This is going to be a very murky area of the law and remain uncertain. It is probably good news for lawyers, but bad news for people who are trading in stocks.

WINAWER: Yes, the Court's opinion can fairly be characterized as a yawn. However, I do think there are some interesting takeaways from the case. First, the Supreme Court did expressly acknowledge the difficulties that may be presented by future cases and whether an insider personally benefits is a question of fact that may not always be susceptible to easy determination, and in some cases assessing liability for gift-giving will be difficult.

The Court, as the prior comments touched upon, left open what constitutes a trading relative or a friend. *Salman* involved a close family relation-

ship, a brother, but how close does the relationship have to be? Is disclosure to an acquaintance sufficient for purposes of obtaining a personal benefit? It remains unclear.

Also, the Court acknowledged in a footnote that it was not at issue whether Salman, the tippee, knew that a gift had been made by the tipper. That is a problem for the government in some downstream cases. Such knowledge could be difficult to establish the further down the chain you get, whether the tippee even knew the original source of the information, let alone that it initially was provided as a gift.

LARRABEE: I agree with the comments that have been mentioned so far. I don't think the open issues are new. I am closer to Josh [Hess], that going back to where we were is largely what has happened. I personally don't view reform of insider trading laws as a high priority or obvious priority of any administration. It is not a very politically attractive topic. There's no public perception, "Oh, my God, we are prosecuting way too many insider trading cases!" No one politically in the country has that feeling.

Letting people who would otherwise be convicted of insider trading not be prosecuted by changing the law by statute or by court action is not an attractive idea anyone is selling either. I don't think we are going to see a lot of action here. The Supreme Court held what they held. We'll go back to life as we knew it probably.

HESS: Add to that the fact that as one of his earliest acts as President-elect, Trump brought Preet Bharara up to Trump Tower. In the Southern District of New York, President-elect Trump personally gave his blessing to the country's most aggressive insider trading prosecutor before he even took the oath of office. I don't think we are going to see a lot of differences, to be honest.

LARRABEE: You can contrast this with Dodd-Frank where Trump has said, "I have a lot of friends who are businessmen. They have trouble borrowing money because of too much regulation from the bank." He can't stand up and say, "A lot of my guys have been accused of insider trading by overzealous people." There's no analog to go to.

ETH: Yes, wrongly accused inside traders—not a big constituency there…

LARRABEE: Ultimately, the nuances will get worked out with prosecutors and defense counsel through settlements and trials at the district court level. It is not an easy place for an appellate court or the Supreme Court to make sweeping changes. You primarily end up with narrow decisions at the appellate level.

MODERATOR: What are the implications of the Supreme Court's grant of cert in *Kokesh v. SEC*, 834 F.3d 1158 (10th Cir. 2016), to resolve a split with the Eleventh Circuit (*SEC v. Graham*, 823 F.3d 1357 (11th Cir. 2016)) concerning whether SEC disgorgement claims are subject to a five-year statute of limitations?

HESS: This is a continuation of a line that the Supreme Court took up in *Gabelli v. SEC* in 2013, which is a case that our firm handled. In *Gabelli*, the Supreme Court confirmed that the statute of limitations that applied to civil penalties under the securities laws applied with equal force to the SEC as it does on private litigants.

Gabelli explicitly did not talk about the issue of disgorgement. This has become pretty important to the SEC. In 2015, the SEC collected $3 billion in disgorgement which is in contrast

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to $1.2 billion in civil penalties. That's a pretty big deal. It is more than twice as much in funds from disgorgement. It is clear they are focused on disgorgement now.

So this issue is very important to the SEC. There is a broad circuit split with the Eleventh Circuit on one end and the Tenth, First, and D.C. circuits aligned the other way.

The main issue is pretty technocratic and only something a securities litigator can love: is disgorgement remedial under Section 2462? It is a case that relies upon a very close textual reading.

I think, without getting into the merits of it, if I am the SEC, I would be desperately worried about the Supreme Court taking this case, particularly on the heels of *Gabelli*, given that there actually was a consensus among circuit courts favoring the SEC's view on this. There's a general rule that I was told when I was a young lawyer that appellate courts don't take cases to affirm them, they tend to take them to do the opposite. So I'd be very worried if I were the SEC with respect to this case. I think the merits are a pretty close call.

WINAWER: The circuit split presents interesting questions of judicial approach. 28 U.S.C. 2462 provides a five-year statute of limitations for an action to enforce a "civil fine, penalty, or forfeiture."

The Eleventh Circuit in *Graham*, citing Webster, Oxford and Black's Law dictionaries, held that disgorgement and forfeiture are synonymous, that disgorgement is a subset of forfeiture, and there is no need to even consider whether disgorgement is a penalty.

The Tenth Circuit and the First Circuit disagreed, holding based on the history of forfeitures in ***in rem*** proceedings and other factors that disgorgement is not a penalty or a forfeiture, but a non-punitive equitable remedy.

So ultimately the outcome here turns on whether review is strictly confined to a dictionary comparison or more appropriately informed by a broader historical jurisprudential context.

ETH: I love the way they look at dictionaries. I am waiting for when they start looking at the Urban Dictionary.

LARRABEE: To parties involved in these proceedings, the idea that disgorgement is not some form of forfeiture because it is not punitive is a pretty unpersuasive position.

WINAWER: Tell that to the person doing the disgorging, right?

LARRABEE: Exactly. This isn't a penalty and it is non-punitive and equitable, get over it.

ETH: So obviously this is a big hammer that the SEC has in negotiating settlements and it would be a blow to them to say, "Wait a minute, you mean we can't just hold out and say 20 years-worth of stuff has to be disgorged, we can only look at a limited period?" So I agree with the comments made earlier, that this could have a chilling effect on their ability to negotiate the kinds of settlements that they want.

WINAWER: Josh [Hess] mentioned the $3 billion in disgorgement in 2015. Look no further than ***Kokesh*** itself, which covered an 11- or 12-year period, with the SEC obtaining a disgorgement award of about $35 million. If limited to a five-year period, the amount would have been reduced to about $5 million. That's a big difference.

MODERATOR: What are some securities issues you see on the horizon in 2017, particularly in light of the new administration?

ETH: We have to wait and see about the midterms. It is going to take a little while for commissioners and directors of enforcement and the solicitor general to get in place. Also, the focus on the federal judiciary at some point is not just going to be on the Supreme Court, it will be on appellate judges and district court judges, but it is going to take time for all of that to develop. If the country politically swings back a little bit in the midterms that will be quite significant because many of the things people are predicting now may not come to pass then.

But if we are talking year three, year four of a Trump presidency with Republicans controlling Congress, then we might see the envelope pushed even further on a whole host of issues, just when you start looking at what the makeup of the federal judiciary will be.

I think that whether all these town halls and all the vocal opposition going on right now are going to influence the 2018 midterm election will actually be critical to how all these issues wind up and how far they will really go.

LARRABEE: The question is really how much is the reality on the ground with the SEC going to change? How far and how fast is it going to move toward the vision that Trump has for a growth-friendly regulatory machine? Before now, I think people might have thought of it as an oxymoron, but I think that's the open issue.

Also, if there is an extreme change in the regulatory machine, what is it going to do to our capital markets in the United States? What is it going to do for the structure and the likelihood of fraud or more market bubbles, and market cycles where we have dramatic dislocations and dramatic changes in work for lawyers? Our history tells us if we move radically toward deregulation and freer markets, five years later we will have a radical dislocation of some form. In our lifetime that's certainly been true.

WINAWER: I agree with that. Coming off of 2016 where we had a record number of SEC enforcement actions, a record number of

FCPA investigations and, an enhanced focus on "gatekeepers," particularly cases involving auditor independence, and high-profile insider trading cases. There are investigations in these areas ongoing right now that won't be affected by the new administration.

Ultimately the enforcement landscape will be shaped by economic and political exigencies, who the new commissioners are, who the director of enforcement is, and what's happening in the business community. That's difficult to predict right now.

But for now, I don't expect any dramatic sea changes. Things over the next year or two will be pretty much as they have been in the preceding year or so.

HESS: In general, you used to have this dynamic of people who tend to regulate more, regulate less, and then you had kind of the Clinton "New Democrat" view come in, which was more friendly to the regulation side, and there was a consensus building around that.

Now what we see is the Republicans have huge tension on this. Trump realizes the tension between the Goldman Sachs crowd and the "Middle America" folks who think that the fiduciary rule is a really great idea. That's a real tension now within that side. And on the other side of the equation, with Elizabeth Warren and Bernie Sanders coming from the left, Wall Street is enemy number one. The left side of the political equation is so focused on that area and hitting hard on it, and the Trump coalition has really had a lot of tension about it.

It is going to be a period of deep uncertainty, and perhaps not a consistent trend toward one particular thing, but lurching wildly back and forth. That's something that concerns people we tend to advise because that is not necessarily great for business.

ETH: We are talking about the federal government and where it may go and how uncertain that is. But there are politicians and law enforcement people in blue states who could take a very opposite view of all these things. I have in mind California, New York, and Delaware.

We talked a bit about Delaware being the guardian of corporate integrity. And if the markets revert to the early 2000s, I have no doubt that the Delaware judges will react. You can have state attorneys general and judges in California and New York deciding, wait a minute, the judiciary actually is a co-equal branch and has a role to play.

So while we are just looking at how the federal government may go in one direction, wherever it goes may lead to a reaction—not just in terms of Elizabeth Warren and Bernie Sanders, but the people who day-to-day write and enforce the laws.

LARRABEE: I think you are definitely going to see some form of that in the securities and regulation arena. Exactly what forum, I don't know, but that dynamic that Jordan [Eth] is describing is occurring in a whole host of issues now, immigration just being the front page news item. It is the federal government expressing a view, adopting a course of action, and states that have a different point of view for their communities are taking a different action and resisting that. That idea that states have their own rights and their own interests and their own communities to worry about, which may not be in line with the overall federal interests of the current administration, that idea is front and center for America right now. It doesn't take a rocket scientist to think about that dynamic and applying it in the securities arena.