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"Gatekeepers" Beware: A New Tool Of The SEC

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In a recent speech at Compliance Week 2014, the premier conference for corporate compliance officers and government regulators, Securities and Exchange Commissioner Kara M. Stein expressed disappointment in the lack of scrutiny and infrequency of enforcement cases brought against what she called the "gatekeepers" – i.e. compliance officers, accountants, auditors and—yes—attorneys.

In Stein's opinion, failures by those tasked with maintaining and promoting corporate compliance have led to tragic financial losses that have harmed innocent individuals and threatened confidence in the markets. Stein targeted attorneys, stating they in particular are rarely prosecuted even though they are deeply entrenched in almost every decision and transaction a company makes. Stein argued that attorneys who facilitate fraud or provide poor legal advice are typically protected from liability by virtue of attorney-client privilege. Although Stein was careful to take personal ownership of her statements, similar statements by other Commissioners recently, including Chair Mary Jo White, strongly suggest that her statements likely reflect the agency's sentiment.

Commissioner Stein's statements parallel the SEC's recent announcement that it will use Section 20(b) of the 1934 Securities Exchange Act to prosecute individuals connected to misstatements that might otherwise escape liability pursuant to the Supreme Court's decision in *Janus Capital Group, Inc. v. First Derivative Traders[1]*. Taken in tandem with Stein's recent speech, in-house counsel alarm bells should be ringing.

In *Janus*, the Supreme Court held that investment advisors can only be held primarily liable under Rule 10b-5(b), promulgated pursuant to Section 10(b) of the Exchange Act, if the investor advisor had "ultimate authority" over the dissemination of the misstatement. By doing so, the *Janus* decision limited the SEC's ability to pursue those who may be responsible for misstatements but who did not "make" the misstatements.

In order to circumvent the restrictions on Rule 10b-5(b), the SEC intends on now using Section 20(b), an untested and rarely utilized provision of the Exchange Act. Section 20(b) makes it "unlawful for any person, directly or indirectly, to do any act or thing which it would be unlawful for such person to do under the provisions of this chapter or any rule or regulation thereunder through or by means of any other person."[2] Clearly, the SEC's motive is to increase the agency's ability to prosecute every individual responsible for facilitating a securities violation, regardless of the *Janus* decision.

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Chair White recently has explained the SEC's rationale. In another recent speech, she stated that Section 20(b) could be a "very powerful tool" to reach those who have participated in disseminating false or misleading information through offering materials, stock promotional materials, or earnings call transcripts, but who might not be liable under Rule 10b-5(b) because they did not actually "make" the misstatement. As importantly, Section 20(b) is a form of primary liability, not secondary liability, so the SEC need not prove that some other person committed a primary violation in order to hold the Section 20(b) violator liable. Chair White believed that would be useful where the "maker" of the statement did not know the statement was misleading.

Admittedly, the untested application of Section 20(b) poses challenges for the SEC. The language of the provision lacks the clarity and succinctness of its companion, Section 20(a). But it is clear that the SEC's new focus on applying Section 20(b) to avoid the hurdles of the *Janus* decision reflects the agency's intent to hold accountable any and all who contribute to the commission of a securities violation. Attorneys are rarely the "ultimate authority" when it comes to corporate decisions. Yet, if the SEC succeeds in its use of Section 20(b), attorneys may not be as safe from liability as they have been before or after *Janus*.

[1] *Janus Capital Group, Inc. v. First Derivative Traders*, 131 S. Ct. 2296 (2011).

[2] 15 U.S.C. § 78t(b).