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Panel Discussion

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Discussion: Midwest Securities Law Institute Transcript, Fall 2015

2015 Midwest Securities Law Institute

Elliot Spoon: If you could all take your seats. We're going to be beginning in just one minute.

So, this is the official good morning and welcome. My name is Elliot Spoon. I'm a Professor here at MSU College of Law and I want to welcome you to this year's version of the Midwest Securities Law Institute. We have a tremendous schedule today, covering almost every aspect of securities law with prominent regulators as well as practitioners. And so we invite you to stay the entire day and interact with our speakers. Hopefully, it will prove to be a most profitable day for you. Now, for the formal welcome to today, it is my honor and privilege to introduce to you the Dean of MSU College of Law, Joan Howarth. Joan.

Dean Joan W. Howarth: Thank you. Thank you, Elliot. I'm not sure how formal I can make this, but I will try to not disappoint too much. First of all, I want to let you know that at the Law College here there are some significant rituals of the season. We enjoy the beautiful campus, and the leaves turning color. We enjoy the football that captures the attention of at least some of us and we enjoy the annual Midwest Securities Law Institute, which is one of the important events of the fall season for us.

I want to apologize for the fact that you all had to make your way through the…we don't have…we're about to have a very nice front entrance, we don't have much of a front entrance historically, but we at least do have a front door. I apologize because, of course, part of my welcome is always to say we want you to be as comfortable as possible. Let us know anything that you need. And the first thing that we did is make you kind of go circuitously around the side door. In ordinary circumstances given the importance of this event, we would have stopped the construction that's going on out front for the day in order for you to be able to have access to the front door. Most of the construction

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has not been as obstructive as today's was. But I just have to tell you that that project was scheduled to be done on September thirtieth. On Thursday, we have scores of graduates who will be here for the dedication. There is as you might have noticed a fair amount of work that is still left to be done. Therefore, given the deadlines that we're up against I figured that it was worth a bit of disruption today for us to try and get back on schedule and for me not to be holding a dedication from the midst of a construction mud pit. So, thank you for your patience with that. I hope that you were helped in your arrival here by various students who were happy to be trying to guide you along the way and I want to thank the students who are here who are part of the MSU Securities and Business Journal. They will be here and available to be helpful to you and are interested in talking with you all day. We're proud of our students. As you know, these are not easy times in legal education we had over twenty five hundred applications for our entering class this year. That is just for example, I know many of you have come from many fine law schools, so just to let you know that that is more applications for example then Ohio State, Illinois, Indiana, Wisconsin, I don't know who I'm forgetting, there are others as well who are able to garner this year. We're doing great. We're very proud of our students and we are very, very appreciative of your participation in this event here today, which gives our students an opportunity to talk with people who are doing the work that many of them hope to be able to do one day. So that's part of what's important about this for us. We're also incredibly grateful for the outstanding presence of leaders in this field. Securities law regulators, folks from the SEC., from the state, from FINRA, as well as leading practitioners. This is a very, very impressive lineup, that has been put together and so I want to thank all the presenters for being here and for helping to… and for being at the heart of this important professional event today. I also, of course, want to thank our institute chair Ameritus Joe Spiegel, who is one of the reasons that this event has created such momentum over the years. And I also especially, of course, want to thank our current Institute co-chairs and that would be Ray Henney, from Honigman, and Professor Elliott Spoon. The work that you all are going to do today, together I hope, will be very, very useful and I have even higher ambition that there will be even some moments of

not just usefulness, professional satisfaction, but occasionally if we put the right people together all of who share a common interest and are very good at it, there are moments of joy from the ability to participate in an outstanding professional community that's been gathered today, together, to move forward, of course, with the work that you are doing. So thank you for being here and I hope that you have a great day to get together. Thank you very much.

Elliot Spoon: Thank you very much, Dean Howarth. And the Dean mentioned our students. I would like to introduce you to three of our student leaders, so if you'd come up.

So beginning on the far end. Matt Morrow who's the editor in chief of the Journal of Business and Securities Law, Emily Granger who is the president of the Business Law Society and Katila Howard who is executive editor of the Journal of Business and Securities law. We are very proud of these student leaders. They have done a lot of work, not only in their own with the journal and with the society, but also a lot of work to make sure today is a successful event. And so as you will notice, there are students around the room. We encourage them to interact with you and we encourage you to interact with them throughout the day. I think it will be mutually rewarding if we can do that. Sometimes the students are a little reticent to do that so please take the initiative, if you would, during the appropriate times. So I want to personally thank the three of you as representatives of the students. And I would like to ask our audience to join me in appreciating their work.

Now, it is my pleasure to introduce to you my co-chair Ray Henney.

Introduction and Summary of Events

Raymond W. Henney: So, I have the pleasure of, first of all thank you all for attending. We very much appreciate your attendance and participation. We really do have an excellent program. We're blessed with really top-notch speakers, both from the regulatory side and from the private practice side. I thought I'd take a few minutes to introduce our

agenda today. Many of us in my generation a couple weeks ago felt the impact of the passing of Yogi Berra. And I know he's a great baseball player and was actually a war hero, but he's really mostly known for his sayings and his statements in fact they're kind of known as Yogi-isms and we've all used them and heard them. “It's deja vu all over again,” or “it isn't over until it's over,” and my favorite is “when you come to a fork in the road, take it.” So, I thought in honor of Mr. Berra it would be appropriate for me to use some of his less known phrases to introduce the various topics and panels.

So, for the first panel I thought that two Yogi-isms would be appropriate for the subject matter. Mr. Berra said, “the future ain’t what it used to be.” He also said, “if the world were perfect, it wouldn't be.” These, I think, pretty well introduce the first panel, which is developments in broker dealer investment advisor regulation. They'll be discussing the ever-changing landscape. We have a terrific panel, which will begin shortly, that consists of two SEC regulators which were very pleased to have come a long way to speak on that. The second panel is on securities transactional hot topics. So, two Yogi-isms, I think best describe, not only the subject matter of the panel, but the panel themselves. So Yogi said, “you've got to be careful if you don't know where you're going because you might not get there.” He also said, “it was impossible to get a conversation going, everybody was talking too much.” As for our third panel, I think two Yogi-isms might be most appropriate. This is the panel on SEC enforcement. Yogi said, “always go to other people's funerals, otherwise they won't come to yours” and, very appropriately given the subject matter of the update, “even Napoleon had his Watergate.” Our luncheon speakers are from the state, the department of regulatory affairs, known as LARA. And they'll be speaking about the proposals for the new regulations concerning the Michigan Uniform Securities Act. I really couldn't find a really good Yogi-ism for this, but I just thought if somehow this fit, “never answer an anonymous letter.” I just think it's good. For our first afternoon panel, which is strategies with emerging growth companies, the following Yogi-ism seem to fit, “no one goes there nowadays, it's too crowded.” That panel also consists of various regulators and also an expert from an investment banking firm,

the ROTH Capital Partners. The subject matter for our next panel, which is the securities litigation update, two Yogi-isms I thought were appropriate. First, "I never said most of the things I said" and then "the towels were so thick there I could hardly close my suitcase." That panel will be focusing obviously on some strikingly recent developments in the Omnicare decision and some other very important and pressing matters in the securities litigation. And for our final panel, it takes a little bit of introduction or background particularly for the students. So, in the 70's and 80's, for some reason, baseball fans thought it was a good thing to take off all their clothes but the sneakers and run across the field. And this was known as streaking. And it became popular in the 70's and the 80's and Yogi was a manager, for a long time, with the Dodgers. And so that event happened at one late night baseball game and Mr. Berra was asked by reporters to comment on the streaking that occurred. And Mr. Berra said, "I don't know if they were men or women, they had bags on their heads." That for me, in so many ways, is the perfect introduction to the securities arbitration developments in that panel.

So, we really hope you enjoy today. We're very much looking forward to what these panels have to say. And we very much encourage you to raise your hand and ask questions. There's a lot of wisdom in these panels and you should take advantage of that. So, thank you so much.

Raymond W. Henney: Our first panel is developments in broker dealer and investment advisors. It is chaired by Shane Hanson. Shane you want to do the honors?

Panel 1: Developments in Broker-Dealer and Investment Advisor Relations

Raymond W. Henney: Our first panel is developments in broker dealer and investment advisors. It is chaired by Shane Hanson. Shane, you want to do the honors?

Shane B. Hanson: I will. Thank you. Thank you. One of the things that you learn especially as you get older, is you want to look to hire and surround yourself with people that are smarter than you. It is good to see the audience with the students because I think we really stand to be well served by the next generation of lawyers coming up, so, thank you to the students for coming. Thank you to the law school and Professor Spoon and Ray. Thank you all for being here. It's a great program. It's fun to be involved in it.

Let me just quickly introduce, as we've got a lot of ground to cover, our speakers from the SEC today. These you would call, you'd call them lawyers' lawyers within the SEC. They have the accumulated knowledge and wisdom in the Office of Compliance Inspections and Examinations "OCIE" and this is the unit within the SEC that is really responsible for guiding the examination program for investment advisors, broker dealers, and other, other regulated entities within the SEC. So they are significant interface with all of us through the examination program.

With us today we've got Jen McCarthy. Jen is THE lawyers' lawyer in OCIE. She is Acting Chief Counsel and has a lot of experience working at the SEC with broker dealers and investment advisors and funds as well. She has a uniquely international flavor, having got to work a bit across the pond with the U.K. Financial Services Authority dealing with both investment advisors and large, and other regulated entities. She's also an east-coaster so, we're glad to have her here in the Midwest. She has her J.D. from George Washington University in D.C. and graduated from the College of William and Mary in Virginia.

Also, on my far right is Kris Easter Guidroz. And Kris is Senior Special Counsel at OCIE and with an, also, international flavor. Kris works in the Office of International Affairs, focusing on cross borders supervisory regulation, but also has a lot of experience across the board with the regulation that the SEC develops and enforces. Kris has worked with overseeing special projects and risk monitoring, with asset managers, with private and registered funds. And has also, I thought this was, was fun, played a key role in developing some of the Dodd Frank rule

making. So, maybe if we have anybody to blame we blame Kris. Congress probably more so but, in any event… Maybe put it this way, Kris, you had deal with what Congress created. So, that might be a good way to do it.

This is what we're going to cover today we're, we're basically going to cover recent developments with the examination program, and some of the risk alerts and publications that have been put out by the SEC. And let me just highlight there, you can read the law, you can read the rules, but when you want to read between the lines, you need to look at some of these risk alerts and some of the speeches that come out and these, these are really important to help really fully understand the SEC's thinking. And I might add priorities, we're going to talk about ongoing initiatives and priorities, I think we get a little sneak peek at maybe the 2016 priorities in the next exam cycle, talking about cases that are near and dear to the chief compliance officers in the room, that have some direct personal impact on them, talk a bit about trading in markets and regulatory developments, and similarly for investment advisers. And just so you know, the SEC is organized in divisions. The division of trading and markets generally deals with broker dealers and stock exchanges. The division of investment management deals with investment advisors and funds, registered funds, private funds, and the like. So, with that overview we'll let you guys give your disclaimer first.

Jennifer McCarthy: So, and I'll give this for all the SEC speakers that are speaking today, the views that we express here today are our own and not those of the commission or our staff.

Shane B. Hanson: Great, thank you, I wish I could say that when I issue legal opinions and stuff, someday. We're going to cover a lot of material today, and I want you to know that in your materials are a copy of the slides, we're going to move around a little bit in them so don't necessarily flip pages. I will keep us kind of as close as possible, but I want you to know that there are links in the materials to pretty much everything we're going to talk about. So, if you go back to your office or, or classroom.

You print it all out it's north of a couple inches thick, so there's a lot of material there and so let's jump right into it.
So, Jen, do you want to talk a little bit about maybe a sneak peek at 2016 exam priority for OCIE?

Jennifer McCarthy: Yeah sure, so before I start, I just wanted to thank you all for having us. We always enjoy coming to this conference. I may be from the East Coast, but I have a little link to Michigan, my cousins are from here and one went to Michigan and one went to Michigan State so not sure who I'm going to root for this weekend. But, thanks for having us. And as Shane noted, our priorities haven't been published yet, but I can give you a sneak preview for what some of them might be. So, there are four areas that I'll touch on right now. The first is our retire initiative. It was announced in June 2015. There's going to be four focus areas of this initiative and it's going to be focusing on both investment advisors and broker dealers that sell products to retail investors.

So, the first focus area is going to be reasonableness of registrant recommendations, focusing on selecting the types of accounts for clients, performing due diligence on investment options, making initial investment recommendations, and providing ongoing account management.

The second focus area in this initiative will be conflicts of interests. Examiners may focus on conflicts that exist as a result of a firm's business structure, compensation structure, personal issues or relationships, or relationships with service providers. Some of the things that may be focused on include whether compliance programs identify and address conflicts of interest, and whether material conflicts of interests are disclosed or addressed.

The third focus area in this initiative, supervision and compliance controls. And here, I think one of the focus areas will be on registrants with operations in multiple and or distant branch offices, as well as representatives with outside business activities.

And then the fourth area that we'll be focusing on in this initiative is marketing and disclosure. So we're going to be reviewing registrants' brochures sales and marketing materials, disclosures to retail investors to confirm that the content is accurate and not misleading, particularly about fee and credentials or other endorsements that they're valid and meet any stipulated standards.

So those are the areas that we're going to be focusing on in the retire initiative, and as was mentioned, we recently published and alert on this so you can take a look at it, it's on our website and has a lot more detailed information about some of the areas that we're going to be focusing on. Cyber security….

Shane B. Hanson: Let me just stop there and jump in with a couple questions. First off the retire initiative is in your slides there. Its got a unique acronym that kind of gives the, the direction. The question there, do you work at all with the Department of Labor and in the retirement space?

Jennifer McCarthy: We do, we work with the DOL on a lot of senior issues and this is one area where we've coordinated with them.

Shane B. Hanson: And one other thing, and just to highlight the marketing and disclosure, do you want to comment on how broad that is? And I'll give an example of what I'm thinking about, is the firms', you know an advertisement for a newspaper when you see it, but would you also consider responses to request for proposal that are prepared by your firm to be kind of in that same category, the disclosure piece anyway?

Jennifer McCarthy: Yeah, I mean I think in this initiative we'll be looking at these types of things pretty broadly. So yeah, I mean I think things in newspapers, radio. You know things like you mentioned, also things like seminars, there's a lot of free lunch seminars for seniors, things like that. So, I think we're going to take a broad approach as we look at these issues.

Shane B. Hanson: Excellent. You want to get CCOs or cyber security?

Jennifer McCarthy: Well I'll touch, well a couple more priorities I'll give you a preview on and then we'll turn to CCOs.

Cybersecurity we're going to talk more about later, but that's going to continue to be a focus area for us. Never before examined investment advisors and investment companies we're going to continue that initiative. For investment advisors some of the things we're going to be focusing on are their compliance program, filings and disclosures, marketing, portfolio management, and safety of client assets. And then for investment companies, a few of the areas we're going to be focusing on also their compliance program, annual contract review, advertising and valuation. And the last area I'll preview for you, dual registrants and broker dealers migrating to the advisory business. And just some of the risks in that area that we'll be focusing on are risks of reverse churning and potential lack of appropriate supervision of firm representatives.

So, stay tuned. Our priorities, we just started publishing them a few years ago, likely it'll come out probably in January or February. We're working on them actively right now. You know talking to examiners throughout the country, to the different divisions, and to the commissioners to develop priorities for next year.

Shane B. Hanson: Okay. On the never before examined, what's your sense of how many of those are out there? And what's the current exam cycle? And how often should people kind of anticipate to have visits?

Jennifer McCarthy: Yeah, so we used to be on cycle. We are not on a cycle anymore. We've gone to a completely risk based program. And one of the risks that we consider is the fact that firms have never been examined, and so, that is, that is a priority for us right now. I can't say yet how many firms that we're going to examine this year, but it is definitely a priority for us to, to get to the firms that we've never seen before. To make sure that they're complying with the law and to make sure that they're aware and understand the laws that they need to comply with.

Shane B. Hanson: One other category of never before examined advisors would be brand new advisors. And just do want to say kind of what the approach is to a brand new registrant coming on board and maybe, you know, if they're coming, switching from state registration or if they're just a brand new registrant?

Jennifer McCarthy: Yeah so, they're figured into our priorities and our risk assessment just like any other firm, but one of the things that we have started doing this year, or last year on a pilot basis, is contacting new advisors when they register and just having a conversation with them, answering any questions they have, trying to learn just a little bit more about their business and as included in their filings with the commission. And that started as a pilot in a few regions, I think Chicago was one of the regions, so it may have touched some of your firms. And it's starting to spread throughout the country. So, I think it's something that will probably become, you know, a practice that we do in every region.

Shane B. Hanson: Okay, great. Well let's move on to chief compliance officers then, and I think, there are probably a few in the room. I know I encouraged a number of clients to send their CCOs, and there's been some developments that are near and dear to their hearts. Because they've been kind of on the target screen, and there’ve been some cases and a lot of talk about CC liability, CCO liability. We've got a couple of commissioners who’ve chimed in and Kris do you want to give us a little bit of thoughts on that?

Kris Easter Guidroz: Sure. When Jen and I were preparing for this we thought that instead of going through all of the number of cases that came out over the last year, we’d just focus on some of the lessons learned perhaps and the key takeaways. We can then talk a little bit about how the Commission is rethinking its approach, or some of the statements that have been made by Commissioners about the need to rethink our approach.

Some of the lessons learned from the cases over the last year include, first off, that an off the shelf template compliance procedure, or code of ethics just will not suffice. A firm can start with that, but the firm needs to really tailor the policies and procedures, based on an assessment of what are all of its activities, what are the risks inherent in those activities, and make sure that they encompass those risks in their policies and procedures.

The second lesson learned is that the compliance procedures may state that a review should be done to ensure compliance, but that's not enough either. The procedures need to describe what is the firm going to do in this review what's the purpose; who's responsible. For example, in one of the recent enforcement cases, the firm's code of ethics said the firm was going to review the personal trading, transaction statements of all of its access persons. So someone did. They reviewed them all, but they did not assess them to see if the person whose trading they were reviewing traded in the same securities that the person traded for a client account. As such, there was no real compliance review done in that case.

Shane B. Hanson: Kris let me interject. A mantra for everyone here on this very point and that is "if it's not in writing, it never happened." So because the whole exam program is based on an essentially a twenty-twenty hindsight review and if there's nothing in paper or electronically to review you have nothing to go on.

Kris Easter Guidroz: This is true. That's key and that's one of our other points later which we'll get to later, Shane. Well maybe we'll just get to that now. Don't ever backdate your compliance reviews or add additional information to them. That could be misleading when the examiners come in. That was one of the bigger cases this year. So just make sure that if you do add in the information it's appropriately dated as to when it was done and make sure your documentation isn't misleading in any way.

In another area where a firm did not accurately assess all of the risk, the Blackrock case that came out this year, the SEC stated that Blackrock did not have policies and procedures reasonably designed to detect and

report potential conflicts of interest when their personnel engaged in outside business activities. It is fine to say you have to come in and report to the firm if you're going to engage in outside activities. But, the policies and procedures should describe what review will be done of those activities and how the firm will identify if there's a potential conflict between the employees outside activities and client interests or customer interests. And lastly if you're a fund manager or registered fund manager, the procedures should say when you should report those potential conflicts to the Board of Directors for the funds.

The third lesson learned is that maybe you have a great code of ethics and a great comprehensive compliance manual, but if you are not implementing it, you're going to get dinged. If you say in your compliance manual that you are going to do something you better be doing it. So, in the S.F.X. matter, the firm had some employees that had access to client and customer bank accounts because the firm had a bill paying service. And part of the procedures for the firm to review cash inflows and outflows, just to make sure no misappropriation occured. Well, that review did not occur and the implementation of the procedures did not take place and in fact clients' money was misappropriated.

The fourth lesson, which Shane touched on and we already mentioned, is do not backdate your compliance reviews. Do not edit them unless you clearly state when the editing takes place, what was the purpose of the re-review, why you re-reviewed the matter. So that it is clear when examiners come in and you have documented the reason for your review.

Shane B. Hanson: One footnote there too, just to highlight, there's two compliance program rules. There’s an investment advisor program rule that is really pretty simple on its face. There's a much more complex rule for registered mutual funds. The mutual fund rule requires a written report that needs to be reviewed with the board of directors. Investment advisors, the rule itself does not call for any particular written document to be created. That's a landmine. Because what Kris is saying is, and again the notion that if it isn't in writing it never happened, you need a report of some kind. Right?

Kris Easter Guidroz: You do and the case, the Wolf case, I'm not sure if everyone's read it, was against a compliance professional. And she acknowledged that there is no requirement to create a log when reviewing for potential misuse of material non-public inside information. But, the firm decided to create a log so that supervisors could assess if she (the compliance professional) was reviewing these potentially problematic trades thoroughly, and documenting her review. And, in fact, she created the log, but did not follow all of the procedures in the firm's manual until the SEC initiated an exam. And then she went back and supplemented her review. And, apparently, none of her supervisors at the chain were reviewing the log timely and did not know that she had supplemented her review, did not know that she had not accurately followed the procedures the entire time. So, as Shane mentioned, documentation is key so that examiners know that you have been fulfilling your responsibilities. But also, you need to pay attention to if there are any changes to that documentation in any way.

Shane B. Hanson: And the other lesson there is you can get hoisted on your own petard.

Kris Easter Guidroz: So, the fifth lesson is to make sure that your compliance policies and procedures are implemented across all of your regulated activities. So, sure you may have one set of procedures that cover your advisory activities if you're an investment advisor, another set of procedures for your brokerage activities if you're broker dealer. But across the board you need to make sure they cover all aspects of those regulated activities. And in one of the cases that came out this year the firm really relied more heavily on its broker dealer compliance procedures. When all of the compliance testing was done, the annual compliance review was done, the firm focused on its advisory business only to the extent that its brokerage compliance manual mentioned some advisory activities. They just completely failed to fulfill their compliance implementation with respect to their advisory business. And in addition they called for, their compliance procedures called for, a review of best execution and yet the firm had no way to distinguish advisory client

accounts from brokerage accounts. When they did their best ex-review and assessed if the fees charged to those clients were appropriate, the employee doing the review just estimated, from her memory, "is this an advisory account or is it a brokerage account that should have commission fees instead of asset based fees?" So, just think about the compliance manual and all of the activities that you carry out when you're developing it and implementing it.

Shane B. Hanson: And for CCO's, one of the key things here is of course, but their personal liability. And that is to say these have been enforcement actions that have been brought against not just the firm, but also against the chief compliance officer, personally. And so that stings when that happens, of course. There's been over the years a number of, of comments by commissioners and in fact some recent ones. Do you want to comment on, sort of the thinking that the commissioners are at least talking about?

Kris Easter Guidroz: Sure yeah, we wanted to get to that if you don't mind.

Shane B. Hanson: Later.

Kris Easter Guidroz: One final point.

Shane B. Hanson: Sure.

Kris Easter Guidroz: Loops and your, your statement about CCO's and that is the Blackrock case.

One of our final takeaways is part of the compliance function. A critical component of it, in fact these days, is oversight of the technology platforms that the firm relies on. And in the Blackrock case, that was just a critical breakdown. I'm sorry, not the Blackrock case- the City Group Global Markets case. Citi Group had implemented trading surveillance for several different aspects of their compliance review and this trading surveillance failed to capture certain trading desks. Also when they

implemented a change to the technology, they just completely eliminated certain coding that the firm had in place. And ultimately at the end of the day the firm had over four hundred ninety thousand trades that violated section 206(3) of the Advisors Act because the firm traded as principal with advisory client accounts. And the firm had over two hundred thousand trades that took place that were actually in securities on the firm's watch list or restricted list and it was all due to technology errors. No one at the firm was actually testing new technology changes to make sure everything still aligned with the compliance procedures and the requirements of their surveillance. I don't believe the CCO actually got charged in that case.

Shane B. Hanson: I don't think so.

Kris Easter Guidroz: OK, but we did want to touch on, a little bit, the letter that was sent to the Commission and some of the Commissioner statements about the need to rethink when a CCO gets captured into these cases and when the CCO is held liable for a firm's violation of its compliance obligations. And I'll turn it over to Jen to touch on it.

Jennifer McCarthy: So, you know as you can imagine, some of these cases involving chief compliance officers have stirred up a lot of discussion in the industry and a lot of concern on behalf of CCO's. Commissioner Gallagher, this June, issued a public statement explaining his vote against both the Blackrock and the S.F.X. settled enforcement actions that Kris mentioned. And further, particularly for you students, it's not that common that commissioners will issue statements about their decisions and cases so this, this is a big news in the industry. And Commissioner Gallagher, you know what he really wrote about, is that he was troubled that the settlements illustrate a trend toward strict liability for chief compliance officers under rule 206(4)-7. And he felt like it sent a troubling message to compliance officers that they shouldn't take ownership of compliance, or that they should adopt less comprehensive procedures to avoid liability. In his view, compliance officers are really the first line of defense and in some firms, particularly small advisers, they're the only line of defense. Particularly, if we haven't

been able to get out there to examine them for a period of time. And so really what, what his message was is that, you know, if there is ambiguity into the role of compliance, that what his though was, is that instead of settling it through enforcement actions that he felt like either the Commission should consider rulemaking in this area, or that there should be some sort of staff guidance on the topic to resolve any sort of ambiguities that might exist.

Shane B. Hanson: I'll interject one point on that. And this is especially true for small firms, is that small firms have limited staff and so quite commonly the CCO, the chief compliance officer, also serves a business line function, in other words they perform some supervision within the firm. And that is an area of course which is a bit gray but when you cross over the line from compliance to supervision now you really are, as they say, part of the problem if there's a problem. And that, I think if you read through the cases and parse them, broadly that there, some of the CCO issues have been when they kind of crossed the line from merely reviewing to doing is kind of the buzz phrase there. If you're reviewing as a compliance officer you're, you're generally applying the firm's policies and procedures. If you are doing the supervision, then if there's a problem that you were supervising you're really not getting charged as a CCO you're really getting, you know, charged with a violation in many respects as a supervisor of some activity.

Jennifer McCarthy: Yeah and that's a great point and that is a similar point to what Commissioner Aguilar meant in, meant in a statement that he published right after Commissioner Gallagher's statement. He was concerned that Commissioner Gallagher's statement, sort of riled up the industry even more and made CCO's fearful about their jobs. And so he published a statement making the point that he felt like, you know, the recent discussions about CCOs had created an environment of unwarranted fear in the CCO community. He emphasized that CCO's who were competently, diligently, and in good faith should have nothing to fear from the SEC. And he talked about that divide between CCO's who are just in the CCO role and CCO's are in the supervision role. And he cited a number of statistics and noted that only five of the cases in the

last eleven years have dealt with individuals who are CCO only and involved violations of 206(4)-7, and he said that in those instances the facts demonstrated egregious misconduct. And he said in many of the, many of the issues that Kris was talking about as she talks through some of the, some of the things you should be worried about and that you should not do. Things like failure to implement policies and procedures to prevent employees from misappropriating client accounts, failure to conduct annual reviews and making material misstatements on filings to the SEC, and many of the other areas that Kris touched on already.

Shane B. Hanson: And let me just add if there's a CCO in the room. Mandatory reading when you go home. You need to print off both of these statements and, in particular, Aguilar's because it will list all of the cases and if you pull it up electronically it'll give you links to all of the cases where CCO's of been found responsible. So I commend the reading.

Kris Easter Guidroz: And I think, when did the Wolf case come out? The final decision just came out by one of our administrative law judges in the last two months. And Judge Kelly also weighed in and that, said even though this was the woman who falsified her records of looking at potential insider trading, the judge said "yes, what she did was wrong, it was terrible and shouldn't be condoned, but in this case she was a lower level compliance professional and we're sending the wrong message if we sanction her when this was a more systemic problem at the firm. We need to think about the message we're sending to compliance professionals" So again, another person at the SEC weighing in on the matter. It will be interesting to see where we go with this next year because as Jen said it's a continued focus of the exam program to look at compliance and supervision.

Shane B. Hanson: Now there's one interesting thing with the CCO of course, they sort of are the center of gravity for knowledge of all bad things that have happened at the firm. That kind of brings us into the whistleblower program, which has become really rather robust at the SEC There's an office of whistleblower. There's a web page on the

SEC's website the deals with whistleblowers. And in so, do you want to comment at all about kind of, what you know, is the CCO who goes to blow the whistle . . . how do you, how do you handle that?

Jennifer McCarthy: Yeah, So the CCO's are eligible for whistleblower awards so that's a point of good news I guess for CCO's today.

Shane B. Hanson: Carrot and stick, right?

Jennifer McCarthy: So in August of 2014, that was our first whistleblower award to a compliance and audit professional. We awarded more than $300,000 to an individual who first internally reported concerns of wrongdoing to appropriate personnel at the firm including their supervisor. The firm didn't take any sort of action within a period of time, so after about 120 days the whistleblower reported the same information to the SEC and that information was integral to the enforcement case. And so the individual did receive an award, and, just to quote from the head of our Whistleblower Office about this case, he said "individuals who perform internal audit, compliance, and legal functions for companies are on the front lines in the battle against fraud and corruption. They often are privy to the very kinds of specific, timely, and credible information that can prevent an imminent fraud or stop an ongoing one. These individuals may be eligible for an SEC whistleblower award if their companies fail to take appropriate timely action on information that they first report internally." And then we've had a more recent case, where, it was in April 2015, and this individual was actually awarded more than a million dollars. The compliance officer had reported misconduct after the company's management learned of potentially impending harm to investors, but didn't take any actions to prevent it. And so, you know, what they really said was that compliance officers are permitted to earn these awards for reporting misconduct to the SEC or investors where the market could suffer substantial financial harm. So, I think the lessons here are reporting internally first, and if no action is taken, then report to the SEC and you know that is very helpful information in our examinations and our investigations and we use that

information to help us risk target the firms that we're looking at and to help us determine what investigations that enforcement is conducting.

Shane B. Hanson: And there is kind of an underbelly to this too. And if you're a labor lawyer or have any labor experience these kinds of issues often come up in a problem employee context with an employee that you want to let go for other reasons, legitimate to the employer, and so there's sort of two sides to how these things play themselves out. Sometimes it's used by an employee for leverage in the termination context so it's a little dicey, you know, in the particular facts and circumstances can make a lot of difference in how it plays itself out. Okay, any other thoughts and we'll move on to cyber security. All right, let's. . . this is a topic here and I'll click back to cyber security. There've been, there's more and more written about this and cyber security really is a hot topic. I think most firms, broker dealers, investment advisors, mutual funds all are struggling with how do we deal with these, I will call them professional hackers, I mean Chinese government or Russian mob, those are, they do this for a pretty successful living and so it's incumbent on firms to do something. Most firms are kind of going: "what do we do?" Especially smaller firms. And so there's been guidance that's come out and we've got it up here and, do you kind of want to tell us a little bit about how this interfaces with OCIE and OCIE's guidance and kind of what the exam program, indirect, indirectly is telling us what you're looking at is what the firm should be doing and go from there.

Jennifer McCarthy: Sure, yeah, I can touch a little bit on the findings of our prior cyber security initiative and then talk a little bit about what we're going to be focused on it in the upcoming initiative that will be going on this year. So, just a few highlights and I encourage you to look at our risk alert on our website, which goes into a lot more detail. But I'll just highlight, and these aren't all going to be deficiencies in our first round of exams, what we're really doing is just trying to learn more about their preparedness of the industry for cyber security incidents. We're also looking at things like Reg S-P and identity theft, red flags rules, things like that. But our main focus was just kind of getting an understanding of how the industry was treating cyber security, how

prepared they were. So some of our findings were that most of the firms we went, we went to about one hundred firms, most of them have been the subject of a cyber related incident. And over half of the firms received fraudulent e-mails purportedly from customers seeking to direct transfers of customer funds or securities. So that's something that's really important to watch out for that's becoming really prevalent. We found that most firms had adopted policies and procedures to deal with cyber intrusions, but we found that generally firms do not address how to determine responsibility for losses to clients resulting from cyber security incidents, so that's something to really think about, as well as, most customer losses were actually the result of firm employees not following the firm's procedures rather than a failure for the firm to have policies and procedures in place. So, you know, here's another practice point, is, you know, the policies and procedures, as you all know, are great, but they need to be implemented, then employees really need to be trained on them particularly in this area to make sure that there aren't breaches as a result of an inadvertent mistake by employee. We found that the majority of broker dealers and investment advisors were conducting periodic risk assessments to identify cyber security threats, vulnerabilities, etc. One of the areas where we found weaknesses, though was that these same types of reviews were not being conducted with respect to vendors and there's been a lot of cyber security incidents with respect to vendors. So, you know, we really encourage you to take a close look at the vendors just as close as you're looking at your own policies and procedures and practices. We found that most firms were making use of published cyber security risk standards such as NIST, FFIAC, ISO, and that many firms were taking steps to keep informed of emerging issues in the cyber security space, you know, such as taking part in industry groups, you know, talking after conferences such as to kind of trade ideas about best practices in this area, and you know that's great that firms are doing that.

For round two, what we're trying to do is a little bit of a deeper dive and looking past the policies and procedures and looking to see how these are actually implemented and how the controls are working. So I'll list out the focus areas and then maybe I'll give a couple of highlights of each

one and what we may be looking at. So, governance and risk assessment, access rights and controls, data loss prevention, vendor management, training, and incident response. And so, governance and risk assessment, I think that that's pretty self-explanatory so I won't go into details there. Access rights and control, some of the things they may focus on are how firms control access to various systems and data via management of user credentials, authentication, and authorization methods. It may include a review of controls associated with remote access, customer logins, passwords, firm protocols to address customer login problems, network segmentation and tiered access. And this is really big, especially with some of the smaller firms. And some of the exams that I've reviewed, you know I've seen that, there is not always a lot of good controls over remote access, you know, some firms are allowing people to access systems from like an open network, like a Starbucks, and there's no security. Things like that. So you know simple things, you know, having to change your password every, every certain amount of months, having strong passwords. Things like that. There's still firms that are not thinking about those things yet and implementing those types of controls. And so, you know, that's something we really encourage you to look into.

So in terms of data loss prevention, examiners may focus on how firms monitor the volume of content transferred outside of the firm by its employees or through third parties, such as by email attachments or uploads. Another area where you know some firms are still allowing outside reps to use Google and things, you know Google Gmail and Yahoo mail and things like that, and, you know, what kind of controls or are they looking at to make sure that that information is protected. Examiners may assess how firms monitor for potentially unauthorized data transfers and the risk review how firms verify the authenticity of a customer request to transfer funds and note, that I mentioned earlier that over fifty percent of the firms in the first sweep were getting fraudulent requests for transfer of funds so this is a really key area to be focused on.

Vendor management, so some of the largest data breaches over the last few years have resulted from hacking of third-party vendor platforms.

So examiners will likely focus on diligence with regard to vendor selection, monitoring oversight of vendors, and contract terms. They may also assess how vendor relationships are considered as part of the firm's ongoing risk assessment process.

And then in terms of training, that's pretty self-evident but, you know, they're just going to be focusing on whether training is tailored to specific job functions and also on how procedures for responding to cyber incidents under an Incident Response Plan are integrated into the personnel and vendor training. So we've seen that a lot of firms have really good policies in place in this area, but the employees aren't necessarily educated about them, or trained on what to do if there's actually an incident. So that could lead to long lag times before the incident is reported and IT professionals are able to address it and so that's another area where we're going to be looking at to see, you know, if there's good training in these areas. And then incident response, so examiners may assess whether firms have established policies, assigned roles, assessed system vulnerabilities, and develop plans to address possible future events. So for both of these sweeps we published a document request on our website. If you're familiar with our program, you'll know that we almost never publish document requests, but we feel like this is such an important area and not all of it necessarily relates back to SEC rules but it really relates to the reputation of our industry and the reputation of your firms, and to the safety of customer assets, and, so we felt like this is a hugely important area. So we've published both document requests on our website. We encourage you to look at them. They're based a lot around industry frameworks such as NIST, FFIAC, etc. And we think it will just be a helpful guide for you, or, we hope it will be a helpful guide for you to look at as you review your, your firm cyber security programs or as you give advice to clients on their cyber security programs.

Shane B. Hanson: A couple of quick points. There's an article in your materials that talks about cyber security. It talks about how the issue of cyber security and hacking intersects really four major areas. Number one, Regulation S-P regulates the protection of data that a firm has, so

there's a current regulatory requirement to protect that data. Number two, there is what's called the red flags rule, which is designed in it's a . . . it's a financial and securities industry initiative to protect against identity theft. And of course it intersects that. The third area is business continuity plans because there's been a growing number of incidents where, not necessarily big firms but even small firms, will be held ransom by a hacker that will freeze up their computers until they pay a ransom. So, it intersects, not only the third parties, but may intersect the firm itself. So, you need to think about that in your business continuity plan. And finally 47 out of 50 states, the last I knew, had breach response requirements and they are not uniform. They vary. And so you need to have a plan. You need to have an incident response plan in order to go: what do we do?" So when the incident occurs you don't want to go: "Shit, "what do we do now?" It just does not . . . I mean this is fast paced stuff you need to know now to mitigate your damage and control the risk. Mitigate the damage and let clients know. So you need to know what enforcement agencies, what police agencies do we need to go to, who to talk to, you need to think through these things ahead of time. So finally, I would note that it's a colorful area of regulation because it taught you there are things you need to learn about spear fishing and things that are in the techno jargon vocabulary that you'll need to kind of figure out. And the bottom line of that is a lot of firms don't know what they don't know. They're going to have to hire a techno geek to come in a consulting firm. It's got to be better than your eighth grader to to tell you what to do on it. So, I know we're going to hear more and more about that. We are starting to run out of time here so anything else on that or should we move on?

Kris Easter Guidroz: Just that there's a link in the materials to a recent enforcement action by the SEC related to cyber security, and it's one of the first privacy cases to come out in a while from the SEC. So you may want to take a look at it. It reinforces some of the things that Jen and Shane talked about. And there's also guidance from the Division of Investment Management for advisors on things to think about and it summarizes most of the things Jen and Shane covered. It also just

reminds people to think about encryption and segregated network data, and things along that line so you may want to take a look at it.

Shane Hanson: And the take away from that case is: doing nothing is not acceptable.

Kris Easter Guidroz: And don't use social security numbers as logins for your clients.

Shane B. Hanson: Let's jump on then to another initiative that is going to intersect investment advisors, and that's anti-money laundering rules that have recently come out. Do you want to tell us a little bit about how the SEC is interfaced with that at all? It's really a heads up for firm's investment advisors had historically not been subject to anti-money laundering rules. FinCEN, the financial arm, or anti-money laundering arm of the US Treasury Department, has now though promulgated rules. I'm not quite sure what stage in the rule making process it is, but you want to. . . ?

Kris Easter Guidroz: Sure, the rule proposal recently came out by FinCEN and the SEC did help draft it. FinCEN had stated in its publications for some time that they had been working with the SEC on it and it did take some time to come out. It's out; it's in the proposed stage. It covers advisors that are registered or required to be registered due to the Dodd Frank changes that rope in certain private fund advisors and take out the midsize advisers from SEC registration and move them to state. FinCEN tried to align its definition of advisor to who the SEC regulates, so that was a good thing. It requires advisors to have a written AML program that covers the four cornerstones that broker dealers already to have to deal with, which are the written policies and procedures, training, independent testing, that kind of thing. It does not have a customer identification and verification program requirement. So, advisors right now will not have to do that if the rule is adopted as proposed. And the due diligence requirements are also not in there. I know FinCEN proposed modifications to customer due diligence as well in the last year, but those are two pieces advisors will not have to think

about unless an advisor has a contractual agreement with the broker dealer to handle some of the customer identification program requirements for the broker dealer. But otherwise advisors should be thinking about what their policies and procedures will look like. You know this is FinCEN's second bite at the apple so to speak so. I personally, not speaking for the SEC, wouldn't expect a lot of modifications to the rule from its current proposed state. The 2003 proposal that FinCEN put out initially has a little more color on why they think advisors are kind of a gateway for potential money laundering activities and terrorist financing activities. So that proposal gave more color, there are some of the red flags identified in that earlier 2003 release that advisors may want to think about when they're monitoring for money laundering. It mirrors many in the Oppenheimer case that came out in January. If you haven't seen that case it was one of the bigger sanctions imposed on a broker dealer by the SEC and FinCEN and a lot of the red flags that came up in that case will be things advisors need to think about as well.

Shane B. Hanson: Okay, let's move on. Jen, I think a lot of . . . we've got a lot of seniors in the Midwest and I know that state regulators have got a lot of emphasis this year on senior protection. The states are actually working on a model act that would help to deal with senior abuse and how financial firms respond. You mentioned the retire program, but there's also a senior initiative. And, I'm going to click back to that. Do you kind of want to comment about what that is?

Jennifer McCarthy: Yeah, sure. So, every few years the SEC and FinRA work together on a senior initiative because, you know, there's so much of our population, as Shane noted, is either retiring or seen to have reached retirement age. So we recently came out with a report of the most recent initiative. I encourage you to look. It's longer than a lot of our risk alerts but it has a lot of good information in there. It discusses a number of deficiencies that we found, but it also discusses a law, I think they phrase them a "strong practices," so I'm just going to touch on a few of those today.

In the area of suitability of recommended investments, some of the strong practices noted, you know, observed at firms where written supervisory procedures were specific to senior related issues including concentration guidelines for seniors of particular types of securities. For training and supervision of firm representatives, one of the strong practices noted with some firms are starting to develop training programs for their reps that are specific to senior issues including trainings on things like what to do and how to spot diminished capacity, as well as elder abuse. For customer complaints, a strong practice noted was that some firms are starting to code senior complaints. They're having a specific designation or code for that and that enables them to respond to senior issues better, to kind of learn if there's different ways they should be approaching seniors or explaining things to them to make sure they understand what they're purchasing. And so we found that to be a strong practice that's starting to pick up at some firms.

In terms of using designation such as senior specialists, some of the strong practices there observed were requiring approval to use senior designation. And then some firms are even starting to prohibit the use of these designations. For account documentation one of the strong practices observed was attaining more detailed information than required by the rules, such as detailed expense information to calculate both short and intermediate expense needs for seniors.

And then in terms of marketing and communications and disclosures some of the strong practices observed there were written supervisory procedures that require approval to participate in unscripted seminars, as well as some firms are starting to use evaluation forms for their seminars, and then supervisors will review them to determine if there's any comments or complaints in the evaluation that may suggest that some of their reps are doing something then that may be violative of the law, and then using that information to address the situation and to develop new training on dealing with seniors. So I encourage you to look at the report. Its on our website. Its probably on FinRA's website as well, but it's a really helpful tool I think and discusses a lot of the trends that we're seeing in this area.

Shane B. Hanson: Two quick closing things because we've run out of time. And that is, there is some SEC rulemaking, so this is sort of what's coming down the pipe, it's in the pipeline. The SEC has got a couple of proposed rules out there. We've got them up on the screen. You can go to those websites that include some ADV changes and modernizing some investment company rules. Do you want to comment at all quickly about those?

Jennifer McCarthy: Very quickly, they're really data modernization efforts to help both the commission and investors get the types of data that they need to analyze. You know, investment advisors, their risk profiles, and to look more closely at investment companies. Some of the elements of that include that the data is going to be filed in a structured data format so it's easier to analyze. There is going to be a modernization of the type of information that's provided, particularly for investment companies so that it's information that's actually relevant to today, so that, you know, both investors and the public and the SEC can use that information to better risk assess their firms.

Shane B. Hanson: Okay, great. And the last kind of closing comment I'll throw in here is, just because it's kind of near and dear and unique to Michigan, there has been a Michigan case, *Pransky v. Falcon Group*, that the Court of Appeals went through and analyzed the unique provision in Michigan's Uniform Securities Act. It's what, in particular, makes it not uniform. Michigan's the only state that has a finder's definition in it, and the Court of Appeals went through and I'll call it deconstructed the statute; they ripped it apart. And so for the students in the room it's a great case to read about statutory construction because the court's opinion kind of goes back and forth; well maybe the legislature meant this, maybe they meant that. Maybe they didn't know what the heck they were doing. Probably. And it's a landmine because it comes out to conclude that a "finder" as defined in the Act, who just introduced "Harry meet Sally, Sally meet Harry. Now pay me something," didn't have to register with the state of Michigan as anything. And that's because the legislature, oops we forgot to say anything about registration.

The landmine is, of course, that there's federal law that says you're probably a broker dealer. And there are 49 other states that if you cross state lines probably also would say you're a broker dealer. And, so be careful in applying that because if you read the SEC's guide to broker dealer regulation, also cited here, it pretty much says the SEC's view is if you get paid anything for introducing people you're probably going to need to register as a broker dealer. Lastly M&A brokers, this is been a decade long effort. The SEC that came out with a no-action letter exempting business brokers from broker dealer registration. The link is there. Three weeks ago NASA came out with the model state rule doing essentially the same thing. The model rule is almost verbatim. There federal legislation that is currently pending in Congress to do the same thing. The Michigan Corporation Securities and Commercial Licensing Bureau indicates that they are including that model rule in the state's rulemaking, so to make it into Michigan law. And this afternoon's teaser, you may get ask questions about the rule making. Finally, FINRA's put out a new rule. Became effective in August that will allow payments to unregistered persons, finders, but in the context of M&A, very limited. If the SEC says it's okay that you don't have to be registered, it's okay with FINRA, too. So you can rely on the SEC's no-action letter there. So with that we've definitely overstayed are welcome. Ray do you want to kick it off to the next group?

Raymond W. Henney: First of all let's thank our panel here, they did a terrific job. Lots of very useful information. We're just going to switch.

Panel 2: Securities "Transactional" Hot Topics

Elliot Spoon: Alright. We're now going to take a U-turn in terms of subject matter, and move from investment advisors and broker dealers to some transactional hot topics. We have a panel that has remained intact for a few years now. Mark Metz, Peter Sugar and Marty Dunn, and they are going to address three different topics. One is developments in proxy access; the second is issues with Reg. A plus and Rule 506(c); and finally

they are going to be talking about the new SEC regulation on pay ratio disclosure. So I think Mark you're starting out; I'll turn it over to you.

Mark A. Metz: Thanks Elliot. Great to be here on the eve of the big game with U of M. And for all of you students I have just two words to say. Go green. [Crowd: Go White]. Thank you, glad you're paying attention. OK, So we want to talk about proxy access first, and there's no new rule to point you or regulation that's been passed, but there's been a lot of developments in this area in the last year or so, and so I'd like to start first just by explaining what is proxy access and then sort of take you back through what's happened over the last few years especially what's happened this year. So first of all what is proxy access? What are we talking about when you hear those terms? And I'm sure if you follow the SEC lore at all, and hear practitioners talking at all, you hear them… Thanks… You hear them talking about this issue. So typically under state law, and most public company bylaws, the board or the Nominating Committee are responsible for coming up with the nominees, every year for election to the board of directors. Shareholders have the right to put their own people up, contest that, but if they want to do so they have to comply with the SEC's proxy regulations, which is a costly and time consuming process, which most shareholders don't want to bother with. Proxy access is a process by which the exerciser of shareholders' rights to nominate their own candidates for the board is facilitated, because it requires the company to put the shareholders' candidates on management's proxy materials. They go to all the shareholders at the company's expense, and if you comply with the restrictions and the rules that are set forth in a particular proxy access bylaw, you won't have to comply by yourself, as a shareholder, with the SEC proxy rules. So proxy access is a way for shareholders to put their own people on in at a much more cost efficient way.

Martin Dunn: Yeah I think that's a big point you're making. You can't overstate it enough. It's not… even when there is a federal rule it doesn't create some federal right to nominate. You have to have the right to nominate under state law, and then this is just a question where those nominees are placed on the proxy.

Mark A. Metz: Exactly… exactly. So it's a… Why are we talking about it this year? Well it's a concept that's been kicked around for a long time. I think Europe-- a lot of European countries maybe the EU, I'm not positive about that, but a lot of other jurisdictions have proxy access by law. The reason it's become a big deal this year, let me just walk you through this, and just bear with me because it will take a slide or two. Let's go through the recent history. So, as you all remember 2008. Big national election. Power shifted from Republicans to Democrats. SEC control shifted, and shortly thereafter in 2009, a proposal came out of the SEC that would have required proxy access be implemented at essentially all public companies other than some exceptions like smaller reporting companies and so forth. That was 2009. 2010 was the Dodd Frank Act, and we sat here in these very seats and told you a lot about Dodd Frank as it related to securities law issues. One of the things that Dodd Frank did was to include a provision that encouraged the SEC to in fact adopt the proposed proxy access rule that it had proposed just a year before. And so taking that cue: shortly after Dodd Frank was signed into law, the SEC did in fact approve a final rule that mandated proxy access. And the SEC rule would have required that companies include in their proxy statements candidates that were proposed by shareholders or groups of shareholders who held at least three percent of the company's outstanding stock for at least three years. And there was a limit that the SEC imposed on the number of nominees that could be forced on a company in that way to twenty five percent of the total board. So a board of eight directors or nine or ten… you would round down… it would give people a right to put two on the ballot for that year. Now the rule was quickly challenged by the Business Roundtable and the U.S. Chamber of Commerce, shortly after it was adopted, on procedural grounds under the Administrative Procedure Act, and implementation was stayed by the D.C. Circuit Court of Appeals. And then the main portion of the rule, in 2011, when the D.C. Circuit heard the arguments and made its decision, the main portion of the rule was vacated, which was very surprising; at least I hadn't seen that in thirty years of practice. And so you would think that "OK proxy access is dead, it's not going anywhere," but what the court and the SEC didn't do was get rid of a

companion change to the shareholder proposal rule in 14a-8 that made it harder for companies to exclude proposals made by shareholders. And if you're familiar with securities laws you know that 14a-8 is a rule that allows shareholders to submit a proposal to the company, and if they jump through all the procedural hoops, and if there's no way to exclude that proposal -- and there's… I don't know… ten or twelve different exclusions in the rule -- then the company has to include that shareholder's proposal in its proxy rules, and the shareholder doesn't have to go out and solicit proxies, doesn't have to comply with the proxy rules themselves in order to have the shareholders vote on that proposal. And so by making it harder for companies to exclude those kinds of proposals, the SEC intended for something called "private ordering" to perhaps take place, which is as Marty mentioned, under state law, shareholders trying to make companies create a right in the bylaws of the company or the organizational documents, so that shareholders could in fact facilitate the exercise of their right to nominate directors. Alright, so that takes us to the 2012 to 2014 proxy seasons… That happened in 2011, and folks including this panel started talking about, "OK, private ordering: let's see what happens… I wonder if this will be a big deal." The first three years after that decision, hardly any shareholder proposals came out. Less than twenty each year, and very few of those actually passed. The terms that were suggested in these proposals varied widely from what the SEC had proposed in 14a-11. And that brings us to the 2015 proxy season, which I would term a watershed year for this because of the New York City comptroller, a guy named Scott Stringer. Remember that name because you could probably be hearing more of him this coming year. Scott Stringer, who's responsible for overseeing New York City's employee pension plans which own a lot of public company securities. He and his staff decided to bring proxy access shareholder proposals to seventy-five public companies; mostly large-cap companies. And they proposed terms that tracked the vacated Rule 14a-11, three percent for three years; maximum of twenty-five percent of the board. More than thirty other proposals were brought by guys like James McRichie, I think John Chevedden, who's… I would call him an associate of Mr. McRitchie. The normal suspects who bring shareholder proposals. A lot of them brought proposals as well at other companies,

and the interesting thing was that all of these, almost all of these proposals, follow that same three percent, three years, twenty to twenty five percent limitation. One of these proposals was submitted by McRichie to Whole Foods Company. And in response to that proposal, Whole Foods decided to propose a proxy access bylaw, with much more conservative requirements than in McRitchie's proposal, and filed a no-action request with the SEC to exclude it under Rule 14a-8(i)(9), which is in that long list of ways of potentially excluding shareholder proposals. And the grounds there are that the McRitchie proposal would conflict with the proposal that the company wanted to put on its own proxy statement, and in accordance with established precedent, the SEC granted the no-action request to Whole Foods, so that Whole Foods could exclude make Richie's proposal. That was December of 2014. A few weeks later, after McRitchie had appealed that to the full Commission, the staff issued a release, and said, "You know what, we changed our minds." They withdrew the Whole Foods no-action letter, and Chair White said, in essence that we're not going to issue any more guidance under (i)(9), until we've had a chance to really think through how (i)(9) is applied. And so that left a lot of people, a lot of companies, especially those who were getting the shareholder proposals on proxy access without a real good way of excluding the proposals, and as a result, many of them got onto shareholder meetings and proxy statements in 2015, and over sixty percent of those proposals that got in there, sixty percent of the more than eighty, were passed. And that means… although… that doesn't mean that those companies all have proxy access bylaws now because the proposals themselves recommended to the board that the board adopt a proxy access bylaw with the three percent, three year, twenty-five percent guidelines. But all of those boards are now in the position of having to decide: is this really in the company's best interests to adopt this, knowing now that their shareholders, a majority of their shareholders, have voted in favor of it, and knowing that if they decide it's still not in the company's best interest to have a proxy access by law, they could suffer the wrath of ISS, a proxy advisory firm, who doesn't like it when boards don't adopt recommendations that their shareholders have made at the prior year's annual meeting. So that takes us to…

Martin Dunn: If I could on the (i)(9), we went past where the staff withdrew the letter, and when you mentioned you hadn't heard of a court case where they vacated a rule, I was in charge of shareholder proposals for eight years and I didn't know that you could actually do that. You know it just it's never happened before -- the staff just goes, “Yeah the thing we did before. We're disavowing that and we're just not going to answer anymore.” It's… How do you just not do your job? You know, I couldn’t figure that part out. And that really did leave… so it's mid-January when this happens. That's right in the middle of proxy season. And companies have already written their letters in, but they haven't written a proxy statement yet. And they are in this lurch because the staff isn't going to give them comfort if they don't include it. And that way they might get sued and lose. And so it completely upended the entire process, and it was really rare.

Mark A. Metz: And I will… I will tell you that I had… I did not have a client with a proxy access proposal, but I had a client that had a different kind of proposal that wanted to use (i)(9). And we had some choices, but none of them were really very good choices as far as “What can we do if you want to leave that proposal out,” and I think what we ended up doing was adopting our own provision that contradicted, and we said, “OK, the proposal’s here, but we've already adopted this other thing that we think has terms that make more sense for our company, and the proposal went down to defeat as it turned out. So that's the background of proxy access. The first question I think I want to propose for people to think about and for the panel to talk about with me is: why not adopt this? What's so bad about allowing the owners of the company more input into who sits on the board and making directors more accountable? Those are the arguments that proponents including many institutional shareholders make in favor of having proxy access rights. Why does it take until 2015 to even start worrying about this and why are companies not quickly jumping on the bandwagon? And I guess I've listed a number of the reasons why the opponents are saying it's not the greatest idea in the world, but I'd be interested in hearing any opinions you guys have before I kind of go down through.

Peter Sugar: A couple thoughts. While the conversation is housed in terms of democracy and voting, you know this is corporate governance, and the governance of corporations, traditionally from conservative bases channeling. There have been restrictions. And the reality in the marketplace is that activist investors have created a tremendous market for change of ownership in companies in the last few years. The Carl Icahns of the world. Nelson Peltz… You can read the headlines and, this is just one more tool in the arsenal. And so the idea that, and I'll just make the general comment, the idea that this is something like voting for president, or voting for your Congress, it's just not quite apples and apples. So the only thing that addresses it in the Access proposals really is the three year, three percent idea which… But you know as Mark's second bullet highlights: short term goals don't necessarily advance the proposition of the corporate business for the benefit of shareholders, and this is going to be open to anybody.

Martin Dunn: Well I agree completely on the notion of corporate democracy isn't really a thing. Right. But we've bought into the fact that apparently it is, and so when you look at it, there's a lot of nuance to these. Of the seventy-five proposals the comptroller brought last year. I don't think in any of them did they say, "We're bringing it at this company because we think they have a bad board." It's always about something else. You know it's . . . while I'm going to run a proxy access proposal because they pay somebody too much, or they didn't negotiate a union contract, or you think of any reason, and in order to raise this proposal, you have to have own two thousand dollars worth of stock for a year – that's the 14a-8 limit. Doesn't really require a whole heck of a lot. But then when you talk to everybody else, It's interesting, it's almost like the access proposals were being used as the tool. Because when you talk to them they're like, "We're never going to use this." I mean think about owning three percent for three years. If I'm a three percent holder for three years at a company, the company's talking to them now. You know I'm not going to sneak up on the company, and a lot of the shareholder activists that run up a quick set of ownership and are pushing for a repurchase or a buy-back or a whatever, they'd get the ear very quickly.

And I don't think they're interested in waiting three years to have a nominee, plus if I own three percent of a Fortune 500 company, I have enough money to run my own doggone contest if I want to you know. And so I really have seen a shift in how people think about this. Between "how do I feel about a shareholder access proposal," and "do I oppose it, or what do I do, and why is it being raised" versus actually having that in my bylaws isn't the worst thing in the world. Because, it really isn't going to come up in most instances. And I've seen a lot… It's been really weird. In the last year and a half I've seen a lot more people get totally comfortable with that idea, and every institutional shareholder I talk to say what I just said there. "We want it there, we need it there, but they're going to be talking to us anyhow." And so I have gone from really hating it to thinking, ehh.

Mark A. Metz: And hopefully I'll have time to get to…

Martin Dunn: I'm try to figure out how they're going to type "ehh" when they do the transcript. *[Laughter]*. I don't know how they'll do the transcript of that. I just realized…

Mark A. Metz: E-H-H I think… I'm hoping that we'll get to… Should I do it or should I not do it this year, and so let me quickly just recommend these to you, and point out a couple of them that I think are the most important for purposes of thinking this through. One is the disruption to the board's functioning. If you think about it, if somebody is elected pursuant to a proxy access bylaw, that person is displacing someone who's already on the board, and is there, not because the rest of the board wants them there, but because they've been forced in. And so that person is likely to be treated adversarially, or at least thought of adversarially on the board, and it's likely to disrupt the collegiality of a board, and if you counsel boards you know that collegiality and ability to work together, work through differences, and be focused on the company's goals and not personality conflicts and private agendas is extremely important to the good of the company. And the second point is the one that Pete started to make, which is really on the short termism. It is not in the company's best interest to have a board that is focused on short term issues rather

than making investments in plant and equipment and things that might make the short term results not look terrific, but are intended to have positive long term effect. Investments in the company that have a positive long-term effect are extremely important for companies' long term health. And then there's some other ones here that in the interest of time I'm going to just skip over.

Mark A. Metz: Let me flip to, for just a second, about next year because this is another issue. We saw this huge change in 2015. The question is -is that going to continue in 2016? Is the issue going uphill, is it trending up, or is this just going to fade into the woodwork? And I have a few statistics up here, which you can see, illustrating how. I have a typo in my slides, that 9% is 90%. So, everything is shifted on these two issues. The board declassification was a governance issue that gained momentum over time. Only 40% elected their board fully annually in 2003. That number grew to 91% elected their full board, that is, declassified their board. The majority vote standard is another example of governance issues that gain momentum through the shareholder proposal process and as you can see from just a few years ago only half of the S&P 500 had a majority vote standard and now, in a short five-year period, that grew from 50% to 85% and changed from plurality which is what most state laws require or have as a fallback position to 85% had this majority vote standard.

So the question I'll pose to you guys very quickly is, is this something that you see as a trend up, that next year is going to be even bigger in terms of governance or is it something that was a flash in the pan in 2015?

Martin Dunn: I think it's going to be like majority vote where it grows until it just becomes the norm because it's been interesting, in meat. When the proposals first came out, I would talk to people in the legal offices and clients and they were like, "No," you know. Man the walls and they go out and if they had to cave and write something they'd write a bylaw that was really restrictive, and then you started seeing the boards go, "Well why are we jumping through all these hoops when we really

don't care that much," you know? It's really evolved to where the boards don't seem as agitated by it and so I think you going to see a lot of people just doing it to take it off the table and not have it be an issue. I really do.

Peter Sugar: I disagree with that. I think what it's going to take is the momentum goes forward, something gets in place along the lines that Marty suggested where it becomes the norm and we see what happens in boardrooms and you can really test out what Mark is talking about in terms of affecting the decision-making process, whether collegiality is lost. I've been in some boardrooms where that's really just a concept. People are throwing things and screaming at each other and turning the lights off and leaving. So I'm not 100% convinced that that's the way decisions get made but I think once there's an effect either on the pocketbook, if this becomes a very expensive kind of process, there will be a pushback against it. I don't see how that really happens, but it's a possibility, and if it is disruptive and it's not working, I think there will be some kind of push.

Martin Dunn: Before we get there, I want to ask you guys a question. One of the most fascinating parts about this is we're going to reach the point in time where an activist has 3% for three years as a company, nominates somebody, and offers to pay that person for accomplishing something on the board. Whether that's legal or not, I've had discussions with Delaware counsel that says so long as they comply with their fiduciary duties, it's not illegal under Delaware law. It just seems wrong to me, but I think that may be a tipping point where people say that can't be the case.

Mark A. Metz: It seems like an inherent conflict of interest to me.

Peter Sugar: Well it depends on the issue in front of the board. You pay that guy to get there, and now if you're the activist and what you're trying to do is get some kind of change, you know, a sale of substantially all the assets or sale of the division, internal kinds of things, or an actual takeover the company or greenmail buyout, a redemption of that

shareholder, what does that guy do or that woman do who has been put into that seat and the field he runs, to all the shareholders, not to any particular one.

Martin Dunn: Yeah, I wouldn't want to be the general counsel running that board. What a headache.

Mark A. Metz: Yeah, it puts that director into a very difficult position then of having to represent that one shareholder's interests even when all the information, when it all comes in and there may be a lot of things that the one activist shareholder didn't know, which is often the case, confidential information, that indicate that selling the company or a sale of the assets, or whatever the issue is, is not in a company's best interests. Or maybe it is, but not now. Maybe a year from now or two years from now we need to revisit the issue and that puts a single issue director in a very difficult position.

So the last point I wanted to make, so I leave these guys a little bit of time, is should I stay or should I go, bonus points to anybody who can tell me who used to sing that back in the '80s, Elliot knows. So, should we adopt now or should we wait? Marty's already kind of expressed the view of what I'm seeing in a lot of the background information I read to prepare for today is that many practitioners are saying it's not such a bad thing to adopt it now, especially when you have more flexibility to choose your terms before practice really hardens around the 3% for three years. And I should say that one size fits all isn't a good thing in this area. For smaller companies, 3% is much easier to get to than if you're talking about Apple or IBM or General Motors, even. A 5% threshold might make a lot more sense for a smaller company or mid-cap company. It gives you more flexibility if you do it now. It may preempt an activist who wants to get the guy, for example, in their example, who wants to get somebody, wants to get the proxy access proposal in so that they can put somebody on the board. It may improve your chances of defeating a subsequent shareholder proposal if the board has already thought the issue through and adopted something that's sitting there when the shareholder proposal comes in.

Finally, everyone knows that there are these companies that produce governance ratings and those government ratings are often used by proponents of shareholder proposals to make the case that their proposals should be adopted, and adopting a proxy access bylaw would undercut that argument. Of course, there are several arguments in favor of holding off and waiting to see what is going to happen down the line. In the U.S., especially, it's not well established what the effects are going to be. There are studies out there that are inconclusive. Some say it would help shareholder value. Some say that it detracts from shareholder value because there's potential for higher costs. Adoption itself and the publicity surrounding that may encourage its use. Marty, I think, disagrees with that, but there are some who believe it could encourage the proposal, or the advance notice-- I'm sorry, the shareholder proxy access-- bylaw to be used. And then the company has other ways of engaging shareholders in the process of who should sit on the board without going to this more nuclear option than proxy access. And then finally, there are many who argue that an activist is usually a short termer, so they're not going to qualify anyway and they're going to just want to solicit their own proxies and they have the money to do that anyway so proxy access isn't an issue for them in any event.

Any other considerations before we leave proxy access? I'm going to pass the baton to Pete to talk about developments in Reg. A and Reg. D.

Peter Sugar: I'm not sure if the slides are that important. So, we're three and a half years in to the Jobs Act era. You remember that piece of legislation, which had a noble objective in its enabling language of increasing access. And I thought maybe what we could do to start the discussion off is try to look at what's been happening in the marketplace with this. Have these Jobs Act initiatives and room-making initiatives really had an effect on capital formation. Are the capital markets easier to access? Are issuers successfully using these rules? This first slide talks about some statistics from the adoption of the Act. I think it's to the end of fourteen because the copyright is dated fourteen from the source material and you can see there's about nine hundred billion, 506B

offerings put out and about six hundred sixty-eight billion raised. Now what's come to be known as the 506(b) offering is, by way of exclusion, a 506(c). If you are familiar with Regulation D, you can look all this stuff up. I'm going to just hit some high notes. Rule 502(c) prohibits general solicitation and general advertising in connection with certain offerings made under the rule. That is, you can't use certain exemptions under Regulation D and, at the same time, advertise or generally solicit. Advertising, we all know what that is, public dissemination of information through media, whether it's the Internet, newspapers, etc., sometimes just announcements at large gatherings like this, although we've got some guidance on that.

When it comes to general solicitation, it's a little bit more complex. It dates back to case law from the '80s and even some concepts from the '70s really about relationships. The basic idea is if an investor is smart and rich, going way back, then it's a private offering. Within the section of for-to concept and offered by an issuer that does not involve a public offering some of the indicia of that are that you have somebody sitting across the table and actually can bargain. Bargain for information first and foremost because that's the securities laws objective toward reaching fairness and bargain on economics if they're really a heavy hitter. They can protect themselves. That's the concept. And general solicitation has been complicated by analysis along those kinds of terms and again I'm speaking generally, but the concept behind them. So, in September of last year, and I think we talked about it last year, a rule was adopted under Regulation D. Rule 506(c), which took this prohibition against general solicitation and general advertising away. There's a consequence I can hit it in twenty seconds so I will for those of you that haven't already engaged it, for the non-506(c) Rule 506 offerings. These are unlimited offering unlimited in size offerings. The issuer must have reasonable basis to believe that investors are credited for an accredited investor only offering or if they claim that that sale is to an accredited investor. If you use general advertising or general solicitation Rule 506(c) requires that you take reasonable steps to verify that a purchaser actually is accredited and the offering must be sold only to accredited investors. So, a lot of concepts with respect to private capital formation

in conflict, as a consequence of this rule, those of us to grew up thinking private offerings are private, that you needed these relationships, are learning new rules and new laws. And, while there are some analogies that are out there. State registered Reg A offerings, for example, where you could advertise, certain kinds of interesting offerings, where it's possible to advertise carefully.

It's new and I think that the activity somewhat reflects it when you see the amount of dollars offered and eighteen billion sold and generally solicited generally advertised Rule 506(c) offerings.

Martin Dunn: You know, when we talked about last year, I really thought 506(c) was going to take off because the notion of being able to fly a blimp outside and run a radio ad and have it be called a private offering so long as I take the reasonable steps to verify, what the heck, right? And it's been interesting that it really hasn't, as the stats show. And I think it really hasn't for two reasons. The first is securities lawyers are kind of wimpy about things and even though it was reasonable basis to believe and now it's reasonable steps to verify and the staff keep saying over and over again it's really not that different, they're like, "Nuh uh, we're not touching it. We're not going to mess this thing up. We know what the other one means. We're not touching this. We're afraid. We're not going to take reasonable steps." I just think that's kind of wimpy, but…

Peter Sugar: It also had this egalitarian thought behind it. They went out of their way to say look private equity funds, if you're out there raising money, you can use this rule. I don't think any of these offers whereby any kind of significant private equity fund…

Martin Dunn: I actually think the second reason it hasn't worked is it's so easy to do a 506(b). But because, as Pete mentioned, the notion of it's not a general solicitation if you have a preexisting substantive relationship with your investor which means you have them, either you or your broker or somebody acting on your behalf, has enough of a relationship to know that that person's an accredited investor. Then

you're fine and you get to use all the brokers. So, most issuers are not having a tough time finding unlimited amounts of offerees and money and everything in a 506(b).

Peter Sugar: If you don't have access and you don't have friends and family and you're not running in the right circles to find money and you don't know a good intermediary or can't afford a one, it seems like that would be the fallback. Let me just quickly bring up the statistics. I think this is the most important thing to talk about because this is very much an interim discussion. We're going to have to see how this develops in a lot of the other things, I'll talk about for five minutes maybe, and are still unfolding. Keith Begins, one of Marty's successors at the S.E.C., had some statistics through June of this year. And I think these are just 2015 statistics. Twenty-nine hundred new offerings under 506(c), I didn't throw a slide up because I got this late, and thirty-nine billion of new money planned that is offered. We don't know what got sold. As opposed to under B, thirty-four thousand eight hundred new offerings. So, that's nearly ten times, with 1.15 trillion dollars offered. Again underscoring and you'll have a panel this afternoon to talk about emerging growth companies and will cover IPO's, the most prominent capital formation device used for complying with the securities laws is Rule 506 and continues to be so. And I think if we stick our necks out a little bit you may feel differently. I think that's going to be the norm for a long, long time.

Martin Dunn: Yeah, I agree. I tend to think the folks who use 506C are the ones who can't pay an intermediary or don't have other access or just look for any way to raise the cash they can.

Mark A. Metz: Or want to use the Internet. It's a way to do… You know, everyone's talking about crowd funding. This is a way of crowd funding to accredited investors. It's really use of Internet in general soliciting that way. But I agree, that seems to make the most sense in terms of a way to use it and it probably is going to outshine the new Reg. A plus, though there are some instances where Reg. A plus also makes sense over against Reg. D, but those are sort of limited.

Peter Sugar: Those are a couple great comments and let me segue to Reg. A in a second. But, one comment Mark made regarding using the internet; 506B offerings are being very, very successfully completed using the Internet. And so this pre-existing relationship issue that we've been talking about, and Marty mentioned some of the elements to the ease of which you can now establish those relationships, and therefore not have a public offering and qualify for the exemption. There's a no action letter that is very, very helpful. The conclusion is, the staff concluded that if you follow the procedures there, you can avoid 502C, the general solicitation prohibition. I recommended it to you. I think one of these slides has a hotlink footnote.

Martin Dunn: It was in August it's up there. It's on the website.

Peter Sugar: OK, it's one of the steps of the website. Also, if you –If you're working on an offering and you're looking at these alternatives, because we have a number of alternatives to talk about. Now, go to the SEC website. I'm not going to cite the ones that are relevant right now because it's easy to find. There are compliance and disclosure interpretations, and there are "no action" letters. They really form a great guide. They're not a get out of jail free card, because unless your facts are identical, the staff tells you that you shouldn't rely on a previous letter. And, more importantly perhaps, it doesn't bind purchasers. It doesn't bind offerees. It merely says that the commission will not recommend taking action if you abide by the specific terms you put forward. But they are very helpful in terms of how you construct your offering, and how you protect it in a capital transaction.

Martin Dunn: Well one last thing I wouldn't say on the on Reg D. You know we've had the prohibition on general solicitation –forever –and it's funny that, all of a sudden, in the last year that, when you could do general solicitation, all of a sudden lawyers started asking a lot of questions about –well what's a general solicitation, like all of a sudden they're trying to figure out between the two exemptions instead of "can I do it." I don't know why they started asking that. But the staff in August,

the same day that they came out with that no action letter, put out ten or eleven interpretations that kind of, for once, put in writing what everybody has always been saying about what a general solicitation is. You know, how long do you have to have a relationship –that long. You know, what is substantive? And so, those interpretations now –I don't think they said a whole lot new from what you were hearing people say for years, but it was really nice to see it written down in one place.

Peter Sugar: I love the way that they did it too: the first one says, "by the way, unrestrictive website –throw an offer out there –that's general solicitation."

Martin Dunn: And that's where 506(c) can come in really handy. If you have a restricted website, then maybe 506(b) works.

Peter Sugar: So, we have some rule making on Regulation A. I want to talk to you briefly about – we want to talk to you briefly about, and give you some stats. In June of this year a rule became effective; increasing the threshold to comply with Regulation A, which use to be called "a mini public offering." Which when I went to law school, I think, Section 3B was one hundred thousand dollars maybe?

Martin Dunn: I mean, all I know is in '91 it went from one and a half to five million.

Peter Sugar: And this is taking it from five million to up to fifty. Part of the JOBS Act legislation. The rule that came out in June decided to break that into two tiers, I think they hired a securities lawyer from Detroit. And we told them, look, it's the auto industry –you've got the O.E.M.'s, and then you've got the tier one suppliers, and you've got the tier two suppliers, and we understand this. And everybody understands, so why don't you call them "tier one and tier two?" So, tier one starts off by permitting offerings under Regulation A. Again, a registration statement is filed. State law compliance may be preempted or may be required – depending on which tier you're under, and how you proceed –and, you are exempt from registering, beyond that, in the normal registration

stream, for up to twenty million dollars. If the offering is greater than twenty million –you can go up to fifty million dollars offered –and again, with an interim report, we've had modest experience with it…there are twenty offering statements filed publicly. About sixty percent of them are tier one, so, as expected, people who couldn't quite get to the interest of underwriters for a registered IPO, but worked near the cap for emerging growth companies –billion-dollar companies –are the ones that are looking at this, and trying to access it. Not much activity so for though.

Mark A. Metz: The real choice between the tier one and tier two is: do you want to…number one, do you want to deal with state regulators? If you want to be…if you want state regulation to be preempted, then you have to go to tier two, but if you choose tier two, then you have periodic reporting light to deal with. You'll have semi-annual reports and annual reports to file, and you'll have, sort of, quasi-8ks to file, and you'll have audited financial statements that you'll have to produce, as opposed to reviewed financial statements under tier one. So there are some pros and cons, and depending on how much money you need to raise, and how many internal resources the company has, you'll have to decide what makes the most sense for your issuer.

Peter Sugar: Let me try to give Marty some time to talk here, and close out quickly. You weren't here for the introduction. Ray Henney channeled Yogi Berra, and said that, one of the Yogisms that applies to this panel is: You can't have a conversation because everybody's talking too much. It was perfect. I was offended at first, but then I had to admit, he probably nailed us. So, I just want to talk briefly –there's a chart in there… there's also a chart on the LARA site that's very useful. You're going to hear from those people this afternoon about the various ways you can conduct Capital Formation Transactions in compliance with state law. I've given you a bit of a chart that takes these exemptions. So, two of the things that we talked about last session, last year, were crowd funding, and crowd funding, at the moment, is more about what the SEC has promised to get out of the regulations. It is ILLEGAL to do equity crowd funding unless you comply with some other exemption. The JOBS

Act exemption is not in place, and you can't use it until there are regulations, and Mary Jo White has promised to share, is expecting to share.

Mark A. Metz: They are so restrictive people won't use them. And it's not their fault, it's in the statute, they just had to follow the statute.

Peter Sugar: Similarly, "Mile Act for Michigan" issuers took off. It looked like it was going to be very hot for a while, it's very cold. There's not a lot going on. Part of the problem is there are some regulations there, and Uniform Securites Act rules that are working their way through the system, and once those regulations come out and its clear how you can get a deal done that way, there may be greater interest and maybe a better alternative.

Elliot Spoon: We mentioned two things before you start Marty: one is – Peter mentioned that –that when you went to law school it was like one hundred thousand dollars, and for all these years I thought, when Peter went to law school, they had just enacted the Thirty-Three Act, *[Audience Laughter]*. Secondly, I'm going to notice that we have our power points this year are all on a template to continue our branding of the Institute. We did receive one request for an exemption from using that. And that request was made by Marty. And it was the exemption to use our template was granted for this year only.

Martin Dunn: And I'm going to fly through these because we just have a few minutes, and really there's a lot there. Everything you need to know is in there. I'm just going to try to describe what happened here in. I'll start off by saying I can't stand this rule. All right, it is to me, everything that was wrong with Dodd Frank –this Conflict Minerals and Resource Extraction. And 953 says, "the SEC has to expand their current disclosure to require the disclosure of the ratio of the median total comp of all employees, and the total annual comp of the C.E.O." Why is this in there? It's not material information; this is done for political purposes. The people who push this are not are not going to invest in a company, yea or nay, is this really going to alter the total mix of information –I

don't think so –especially because you already know the C.E.O.'s comp in excruciating detail. And so, this falls into trying to accomplish something else. But it is what it is, it's the law that, the SEC had to adopt, and so you have it. And what does it very basically say? Well, to give you an idea of how political this is, they received two-hundred and eighty-seven thousand comment letters. All right, so it gives you an idea. I don't know if there are two hundred eighty-seven thousand people who care about securities laws or securities, to be honest with you, so I don't know where that comes from. And so, what you saw, is we now have item 402(U), of Regulation S-K. Four-zero-two describes how you describe your executive comp, and your director comp. And when I was first with the S.E.C, 402 had like: A, B, and C, I mean that was about it. How much do they make, how do you figure that out? You know, it was pretty much all you needed to do. And now it's excruciating detail again. And what 402(u), requires is: the medium annual total comp of all employees, annual comp of the C.E.O., and the ratio. And to get into how detailed it is, it even says how you have to explain the ratio. It has to be fifty-to-one, or it is fifty times that. It can't be two million dollars-to-forty thousand dollars. It has to come down to that ratio because that's the purpose of this whole shaming exercise. So, that's what's there, and it can't be a percentage. So, really quickly, to figure out how to do this: you have to figure out who's an employee –that's on this list. An important part about this is you include part-time seasonal, and temporary employees, but you don't annualize their pay. You only annualize their pay if they are a permanent employee. But that's important. So you look at anybody employed within three days of the last completed fiscal year. So what you do is, you look at your last three months, you look at everybody there, and you figure it out. The reason I don't get as agitated about the not annualizing is, the key word to this entire thing, and I'm just going to some all this up with that, is median – it's not average. So, what you do under this rule is: once every three years, you pick a day within the last three months of your year, you go through everybody's comp, and you figure out who is the median employee. And they get a badge or something. I don't know. And so you know –a median, you know in that group. And so you pick your median employee and then he or she, you take that number and compare to the

C.E.O. exactly going to the end, just like you do with the C.E.O. for summary comp table-- the total comp. You do that for all your employees, and find a median employee's total comp, and then you disclose the ratio. A couple of the "gimmes" that they gave here are: there some de minimis exceptions for non-US employees, there's a data privacy exemption. You're allowed to make cost of living adjustments for non-U.S. employees, which I think was vital to this whole thing. But you only have to figure out of the median employee once every three years. And then at the end of the next two years, you just take his or her total comp and use it. And you don't have to recalculate the median because that's the most expensive part of this exercise. So, at least they cut a break there. They also said, if there's a significant change that would make the disclosure of ultimately different, you need to disclose that. So it's not like you can completely ignore it every year. And then that's just what you do. The key is the medium part. What do you have to do to figure this out? Just think about the logistics of this. I mean how many hundreds of thousands of employees do some companies have. So what they did is, you can do statistical sampling, you can come up with your various ways of doing it. The whole thing is built around transparency to how did you get there. So companies can take different methods, they can take everybody's W2. You know, if you only have U.S. employees, or something, and say "here's exactly how we did it." But you just have to be clear as to how you did, and make it there. One last thing I will say is, it says "additional information disclosure is permitted," which I never knew that you couldn't put other stuff in, but they want to make it clear you could. But it's funny, it's like with GAAP financials and Non-GAAP financial statements, it has the same rules about it can have more prominence it has to be explained you know it all goes in there so you can say more. It starts for fiscal year 2017. So, I think you're going to see people next year ramping up their systems to figure out how to do it in 2017,and I think next October when we're here we'll give more detail on how to do it.

Peter Sugar: In looking at this thing, I think it's like a litmus test for idiocy. You know the E.G.C., rules cut back on the certification of internal controls, and reporting on it, and auditing it. And I think this is

going to be a terrific exercise. But one point that Marty made that I think we should highlight, the consequence of this –because it's required under 402, it now is the basis for violating the misrepresentation rules; 10(b)(5) in section twenty, etcetera and Section Eighteen; the Exchange Act, and it's going to be interesting to see whether there are lawsuits, because the stat is not correct. It doesn't follow the methodology.

Martin Dunn: And that's the last slide there. They made a point of saying that this information is deemed filed, which is the liability point.

Mark A. Metz: And it has other ramifications. The ones who were pushing for the change in the statue in the first place; what I think that that they wanted to cause to happen, I think will happen, which is that people who are below the median compensation will, I think, lose their morale, or start pushing for higher wages because they're not median. Of course, what does that do to the median then? It pushes the median up, and it changes the cost structure the company, and cause layoffs. Which is to no one's benefit. It also it makes a much longer section than is necessary, even longer. If you look at it-- if you look at a lot of proxy statements –I look at a lot of proxy statements, for various reasons. And the compensation disclosure dwarfs everything else. Some of the things that are really important to shareholders like; what are the company's government's policies, how does a company manage itself, that's a page of bullet points. But compensation is forty pages, depending on how long CD&A is, and we're talking about another two, three, or four pages of life that we want to reassess on top of that. *[audience comment]* Right, and by the time you explain all of those things –even explain why it was, or was not permissible to not re-determine who your median employee was. Because we didn't have significant changes and that was because we didn't do any of these things. So it's just an incredible amount of detail. And to the SEC's credit, they were required to think through all of these details in order to come up with a rule, but so many details and companies are going to spend a lot of money to come up with this one number, which in my view, and I agree with what Marty and Pete said; is not going to be material to shareholders – it's not going to change how they vote, or whether they buy or sell the company stock.

Martin Dunn: Right because like I said, you've already got the comp of the C.E.O. explained in detail, so this accomplishes something else.

Audience Member: It accomplishes full employment …Any number you want is going to be able to, with that equation, they'll be able to dictate. I mean who even knows what an employee is today, let alone adding up their compensation, but I appreciate the fact that you're keeping us employed to the fullest extent.

Elliot Spoon: Let's thank the panel for a very informative panel. Now, scheduled break for ten minutes.

Panel 3: SEC Enforcement Update

Raymond W. Henney: Our next panel concerns SEC enforcement update. We're very pleased to have on the panel two representatives of the SEC, John Birkenheier, who's in the far end, is the supervisory trial counsel of the Chicago regional office. He is a Spartan undergrad and a wolverine J.D., is that correct?

John Birkenheier: That's correct. Four generations on one side, three on the other. *[Audience laughter]*.

Raymond W. Henney: You'll tell us later who you are rooting for won't you?

John Birkenheier: Maybe. *[Audience laughter]*.

Raymond W. Henney: Next to him is David Van Havermaat. David is a senior trial counsel at the L.A. regional office. David I think is a wolverine undergrad?

David J. Van Havermaat: Correct.

Raymond W. Henney: And next to him is my partner Richard Zuckerman. Richard Zuckerman is at Honigman Miller Shwartz and Cohn and we're all still trying to figure out what Richard is.

Richard E. Zuckerman: Well, I don't know about that. [laughter].

Raymond W. Henney: The SEC, there are 4 or 5 topics they would like to cover. The first one and the one to take most time is a very dynamic topic, which is the SEC administrative proceedings.

John Birkenheier: I will begin by explaining exactly what this issue is about. When the SEC decides to bring enforcement action against an individual or a corporation, it has two forums it can choose between. It can either sue a defendant by filing a complaint in federal court or it can initiate an administrative proceeding, which is essentially before the SEC itself. In that proceeding the division makes allegations against the respondent, which in the first instance are decided after an evidentiary hearing held in front of an administrative law judge. And, after that hearing, an initial decision is issued by the ALJ which can then be appealed to the Commission and the Commission's decision becomes the final agency action and the decision of the Commission can be appealed to a court of appeals, either where the respondent resides or in the District of Columbia. The Commission has had the authority to bring administrative proceedings since the Commission was created back in 1934, although I think we actually opened our doors in 1935. Over the decades the congress has from time to time by statute expanded the Commission's authority to bring enforcement actions in administrative proceedings rather than in district court primarily by expanding the classes of persons who can be charged as respondents in an AP and by expanding the categories of relief which the Commission can order in administrative proceedings. The last such expansion was in the Dodd Frank Act and the primary consequence of that change was to allow the Commission to impose civil penalties against persons who were not registered with the Commission, in other words not in securities industry, in administrative proceedings. So now, you essentially have the same types of relief available to the SEC in enforcement actions both in district

courts on one hand and in administrative proceedings on the other. In the last 12 months, there have been only a handful of administrative proceedings that have been initiated utilizing that Dodd Frank authority. It's not very common that people are charged in administrative proceedings, who could not have been charged prior to Dodd Frank. That's sort of the background of the APs v. District Court.

Richard E. Zuckerman: Let me give you the other side of the coins interpretation of all of that, which sounds very nice. It's all accurate, but it is kind of like the surface of all this that is really going on, which has changed dramatically even since we first started to first talk about this year's presentation back in the summer sometime. The issue that really is at the forefront of the most litigation over the power of the SEC to conduct ALJ, administrative law judge, proceedings has to do with whether or not ALJs are constitutionally required to be appointed to their positions in a certain way and or whether or not they can discharged from their position in a certain way. So, the history is kind of right, the ALJs are appointed under the Administrative Procedures Act, it has been around forever. The APA gives most if not all federal agencies the right to have ALJs, and the ALJ process has been with the SEC for decades, but it's kind of a rocket docket procedure adjudicated somewhat similar, from my point of view, to what an arbitration would look like. You get one ALJ, generally, and they have to actually render a decision in specific time frames depending on the nature of case. So, I can't do this from memory. For example, they institute the proceeding under the ALJ procedures as instituted by the SEC, which has their own little book of rules about how these ALJ proceedings are handled. There is 120 days for what are called 12J stock revocation cases. These guys can explain what that is if anybody wants to know. Two hundred and ten days for cases that are filed as a result of an injunction or conviction. It's kinda like res judicata stuff. And 300 day cases are for those seeking sanctions for violation of the securities laws. Ordinarily you would think when you look at history of the stuff, these are like little cases outcome determined, why file lawsuit in federal district court? You know maybe a judge doesn't think SEC is entitled to any type of relief even though they established liability. This is an expedited efficient procedure. Well, Dodd

Frank came along and section 929 of Dodd Frank said "ok, what we're gonna do is we're gonna let ALJs impose financial penalties against nonregistered entities and individuals." So, then SEC decided, my take, that they're gonna go after real people. They are gonna go after substantial people doing substantial bad things according to what the SEC said or thinks and their gonna do ALJ proceedings, from my point of view, because they are rapid they are efficient and I'll get to some of the negatives in a second. Low and behold, real people hired real lawyers and then all of sudden you have a series of challenges to the authority of the ALJ. Most of which are launched under what's called an Article 2 Appointments Clause challenge to whether or not the ALJs are inferior government officers under Article 2 of the U.S. Constitution. Hence, if they are inferior officers they haven't been appointed in the right way.

John Birkenheier: Richard let me interject a few things . . . by the way Richard is a really good advocate, but there were a few serious factual mistakes in what you just said *[laughter]*.

Richard E. Zuckerman: That's why I am a good advocate.

John Birkenheier: I don't think that will change your views or maybe views of people on either side of this issue, but the APs traditionally have been the forum in which the Commission has brought most of its cases against people in the regulated securities industry, and what that means is a lot of our most complicated and biggest actions have been brought as administrative proceedings. All of our failure to supervise cases, all cases involving sales, I should say most cases involving, sales practice abuse, market manipulation, etc., by people in the industry have been brought as APs and those are all cases in the 300 day track they are all real cases, they're all contested cases. Keep in mind that with the APs, as with the injunctive actions, the majority of our cases settle. And I think maybe Ray or Richard could express views on whether or not there are a lot of APs in which the respondent preferred to have the case brought as an AP, if it is settling, rather than as an injunctive action, which is something that factors into the numbers too. But, I just want to correct the impression, it's not that the APs have traditionally been the follow on

APs or 12(j)s only. There has been a significant number of those cases, which have really been serious enforcement cases, and many of which have been litigated. All the auditing cases, all the cases against auditors, are brought under the AP form also.

Raymond W. Henney: Ok, so one of two big cases. But the follow up on what John is saying, there is ah, while we are talking from the defense standpoint and Richard will be chiming in about the disadvantages of the AP process. One of the advantages is to avoid publicity, particularly publicity in your own home town, rather than having a federal court action that the SEC brings, it's gonna hit the local paper or wherever you're headquartered. You have an administrative settlement in Washington, D.C. And, yes the SEC will do a press release, but this is back of the business section stuff and not front of the business section, or front page of the paper, the fact that your company is the subject of SEC settlement blessed from the local federal judge.

Richard E. Zuckerman: Well, I hate to criticize my partner, but while it is true that perhaps the disposition is less public in an ALJ proceeding, the institution of the proceeding is on the SEC's website. You can go look and see all the ALJ proceedings that they file and the media is pretty good at tracking real people and real cases, And so, one of them is in the material, but I have to be somewhat careful, there is a fairly significant case that involved Lyn Tilten and that was instituted as an ALJ proceeding and bing bam boom it is all over the front pages of newspapers because she is a very common and aggressive venture capitalist of one kind or another and the manor by which she conducts business is something the SEC is looking at. So yeah, you might be able to dispose of the case a little more quietly, but settlements with the government can't be confidential. They are available, they can be FOIA'd. And so, I'm not quite sure there is a real benefit to the client, although every client you represent doesn't want anybody to know the government is chasing them. On the other hand, when we get to the point of what's the difference between being sued in federal court and having to go through an ALJ proceeding, you might see why it is the client might prefer to be sued in federal court. But as soon as we get through

what all the downsides are, the SEC, out of the eleemosynary of their good heart, has now put forth and published a whole series of changes to the ALJ proceedings in a sense of fairness having nothing to do with all the litigation about whether or not these are good or bad proceedings.

David J. Van Havermaat: In touching on that, I think it makes sense at this point to go through the some of the differences between litigating in district court and litigating in administrative proceedings. Before I go further, I will give the disclaimer, and retroactively apply that with John's comments as well, that what we say does not necessarily reflect the view of the commission, or the staff, or the ALJs, and they'll disavow all knowledge that we were even here. [laughter]. So, take it for what it's worth.

Richard E. Zuckerman: As long as he doesn't blow up in two seconds, right?

David J. Van Havermaat: We'll see. If you've dealt with district court actions there are a lot of similarities but also a lot of differences and most of the differences in administrative proceedings are keyed upon the fact that for the types of proceedings that we're most commonly talking about, which are the 300 day window. The administrative law judge is required to issue its initial decision within 300 days from service of what's called the order instituting proceedings, which is the version of the complaint in an administrative proceeding, and because of that there are very tight constraints on the time that is allowed for certain procedural issues in administrative proceedings. As a primer, one of the things if you haven't litigated an administrative proceeding before, you'll have a client that's served with the order instituting proceedings, which we call by the catchy name OIP, but you'll also get from the administrative law judge very soon after that this document that's called the order scheduling hearing and designating presiding judge. And if you are not familiar with this it can cause some consternation because you get this literally a week, two weeks into the litigation and it says judge so-and-so is assigned to your case and, oh, there's a hearing set for your case in two weeks from Tuesday in Washington, D.C. at 9 AM where the

hearing is going to take place. And you get that and you think, "Holy crap am I going supposed to be in DC in two weeks to start this hearing? I know these APs go quickly but I didn't think they went quite that quickly." What happens when you get that is it is essentially a placeholder it doesn't mean your hearing is going to take place in 30 days. The typical process is that the Division and respondent would get together and petition the administrative law judge to not hold the hearing that day and to schedule what is called a prehearing conference, which is essentially the same as a status conference in federal court where the administrative law judge will ask questions about how long the parties think the hearing is going to take, she'll give her opinions on that, who the witnesses are going to be. She will give her opinion on a lot of things you would encounter in a status conference or in a scheduling conference in federal court. The most significant difference as a result of timing has to do with discovery. And the mechanism for discovery in administrative proceeding is very different than what happens in a district court action. In an administrative proceeding the division of enforcement is required, within seven days after instituting the order to institute proceedings, to turn over basically its entire file to counsel for respondent or to the respondent if he or she is pro se. And that incorporates essentially the entire file, it is things like subpoenas that were sent out, requests for interviews or documents that were set out, and any documents that were received in response to those requests, transcripts and exhibits and essentially any other third party productions. So, if the Division received any documents from a third party it's required to make those available to the respondent for inspection and copying but for most practical purposes they're generally provided electronically.

Richard E. Zuckerman: Question is that you're required to produce everything in seven days or begin the production?

David J. Van Havermaat: Technically it is to begin making the documents available. But again we take that responsibility very seriously. It's not like when you begin a production in response to a request in federal court where you say here are a handful of documents, I'll give you the rest you know in a month or so and--

Richard E. Zuckerman: I would just ask.

David J. Van Havermaat: Yeah, that's not the case.

John Birkenheier: That's a good point, but it made more of a difference say ten years ago than it does now because the way that we produce things now is to send you an external hard drive. Right so, it used to be we'd offer you the chance to come to our offices and look through the boxes of paper, so as not to make copies of things you didn't want. But really the production nowadays in a case especially where there is council is just to send a hard drive when the seven-day deadline arrives.

Richard E. Zuckerman: So, let me just juxtapose another point that Dave probably is going to talk about, the SEC takes their time. And frankly from my point of view, that's good because they are very thorough and I am not being sycophantic. They are very thorough. They read everything. They know the file. You know it's not like sometimes dealing with the U.S. Attorney's Office where it's on the fly and nobody knows anything. But during the course of their taking their long time they may conduct dozens of interviews and depositions of people that they think have information relevant to their case. And you get all that. So, then you read it and you say wow Mr. Smith said that, but you know, I think Mr. Smith is really off base. I think I want to depose Mr. Smith myself, now that I know that my client's being sued and the answer to that is?

David J. Van Havermaat: Well, I guess there are a couple answers to that and one is if you're referring to, I think you're touching upon the fact that the SEC investigations do take a lot of time sometimes. I think you know my response to that would be. We are trying to discern the facts that your client knows. You have a client that has particular knowledge in most instances about the facts and circumstances that we spend months or years trying to figure out.

Richard E. Zuckerman: Innocence has nothing to with this of course, but OK.

David J. Van Havermaat: So in that regard I think that the respondent is particularly especially placed to have that knowledge that the Division has had to essentially work for months or years to get. Now, to touch upon your point of well I think there might be something else there. That actually relates to one of the other issues that is an advantage to respondents in the administration proceedings that the division of enforcement is required to turn over any Brady material. And for those who aren't familiar Brady in the criminal context means any material exculpatory evidence. So, if we're aware of anything, even if it's not part of our official file, say for example, we've interviewed a witness whose story has changed or possibly if he's expressed some doubt about liability of the respondents. I won't go into the finer points of all that Brady material is, but if there's material exculpatory evidence we're required to turn that over. And an important note there is, when I talked about the turning over of the investigative file we have, we were allowed to withhold documents based on privilege. The Brady material has no privilege restriction. Brady trumps privilege. So, to the extent there is anything out there that is materially exculpatory to a respondent we are required to produce that without any motion by the respondent.

Richard E. Zuckerman: Yes, but I want to depose these guys if can I depose them.

David J. Van Havermaat: Well, the answer to that is generally no.

Richard E. Zuckerman: OK, fine.

David J. Van Havermaat: Generally the answer is no because depositions in administration proceedings are typically limited to the case of an unavailable witness or if there is a witness that there is a perceived need to preserve his testimony for one reason or another, maybe leaving the jurisdiction, maybe unavailable. There is generally not a provision for fact finding through depositions. But again, the

respondent in our cases is going to be most likely to have access to these people aside from depositions. And I think that applies even to third parties that the respondent has dealt with. Most of the cases that we have, it's the Division against a bunch of a respondents and a bunch of witnesses that are friendly to that respondent.

John Birkenheier: Well, you know the auditing cases are great examples of where the majority the witnesses will be the respondents, and then other partners or employees of the auditing firm. You know, I think another thing about the discovery under the rules, when you read the SEC rules of practice regarding discovery what you'll see is they're very, very, close to the rules of criminal procedure in this regard.

Richard E. Zuckerman: Let me ask you, you mentioned Brady material, there's something else called Giglio material, which is impeachment material that is not necessarily exonerating. Did you get that? Yes. OK.

David J. Van Havermaat: That's covered by Brady.

Richard E. Zuckerman: OK. So, you use Brady on both sides of the coin. Okay.

Raymond W. Henney: Dave, Could you comment on how the SEC picks whether or not to go to federal court or to using the AP process?

David J. Van Havermaat: Yeah. The SEC has issued some guidance in that regard. I'll go through the factors and try and explain them a little bit with the caveat that these have been released fairly recently. It doesn't mean there's anything new happening here, this is really just a statement by the SEC of guidance to the staff in terms of when to choose a District Court action or an administrative proceeding. It's not formulaic, the factors aren't exhaustive. These are really just factors to consider. The first one is the availability of the claims legal theory and forms of relief in each forum. An example of that would be the failure to supervise cases that can only be brought in administrative proceedings. Relief

defendants, for example, can only be sued in district court action, so that is an important factor in our determination of where to proceed. The second factor, which is something that's already been touched upon, is whether any of the charged parties is a registered entity or associated with a registered entity. Historically that has been more typically brought in an administrative proceeding and there are reasons for that. One of the more significant reasons is that if you have someone that is in the financial industry, one of the things that the Commission would like to do is get that person out of the industry if you've got someone that's engaged in fraud. It's one thing to get an injunction and penalty, but the Commission's mission is to protect investors and by going through the administrative process you can get an industry bar or a suspension that wouldn't be available in a district court action. The third factor that the Commission has identified is cost resource and time effectiveness of litigation in each forum. Probably the most important example here is, if we are aware of an ongoing fraud we will generally go to district court because we will try and seek such relief as an asset freeze, the immediate appointment of a receiver, things like that, that are not available in administrative proceedings. On the other hand, administrative proceedings do go a lot faster and it is a generally less resource intensive, so that is something that factors into the staff's consideration as well. And finally, the fourth factor is the fair, consistent, and effective, resolution of securities law issues. And a couple points there. One is the administrative law judges see complex securities matters all the time. They have expertise in that area. Of course not to say that federal judges don't, but this is really the bread and butter of what administrative law judges do. So there is, you know, the thought that they have some particularized expertise in these areas. Also, if there is a complex or a novel matter, one of the thoughts that the staff is supposed to give is: is this is a situation where it would be important to have, or helpful to have, the Commission possibly weigh in through an administrative, or not through an administrative law judge but through the appeals process for the Commission to be able to speak to a particular legal issue. Now again, these are very fluid and very . . . essentially they're just guidance. They're certainly not formulaic, but they are things that we consider in

each case in determining whether to bring a matter in district court or administrative proceeding.

Richard E. Zuckerman: So let me weigh in here and try to give some context, though I think I'm fairly accurate. This is reasonably new, you know. Why is this reasonably new? Well all of the litigation over the . . . whether or not the ALJs are an appropriate, legally constituted way to adjudicate these claims, people were raising a variety of claims around the country. One was an equal protection claim. Well the SEC has prevailed on that. Which is . . . why are you taking me to an ALJ proceeding? I'm entitled to go to a federal district court. You're taking everybody else to federal district court, but not me. I think they prevail.

Raymond W. Henney: When you say they prevail?

Richard E. Zuckerman: In other words you're not going to you're not going to beat down an ALJ proceeding on the grounds that somehow or other you're entitled to go to a Federal District Court.

Raymond W. Henney: But just so it's clear to those who may not be. When you say that they beat it. The beating was simply that they had to have the AP judge decide that issue?

Richard E. Zuckerman: Yes.

Raymond W. Henney: It wasn't that there's been a substantive determination whether or not that is a good claim or not. What the SEC wanted was them to run their course through the AP process before they come to federal court.

Richard E. Zuckerman: Well, that no. Well, that's a different issue. That's an issue that comes up in the appointments clause issue. Whether or not you can . . . well now really going to go off to the left. Well to the right. [laughter]. There's a part of the challenge that's been launched. Enjoin the proceedings all together. Until we the litigants can argue in a federal district court. Meaning, well, in a federal district court that the

proceedings itself are unconstitutional and if they're constitutional, so the litigants say, we shouldn't go through them at all. Those suits are filed in federal district court. The root of an ALJ proceeding as you know an ALJ . . . assuming the decision is affirmed by the Commission you then go to the U.S. Court of Appeals, if you don't appeal the commission to the district court. The SEC argues federal district courts have no jurisdiction over these claims. You don't adjudicate these claims in federal district court and by the way the ALJ itself is competent to decide in the first instance, like an arbitrator, whether or not the proceedings are constitutional or not. And like any other issue in the course the litigation you don't get piecemeal appeals you wait till you lose and you go to the court of appeals. And some circuits have enjoined and others haven't. And that's why this litigation is. . . you know the Second Circuit weighed in, the Seventh Circuit weighed in, the District of Columbia has weighed in I can't remember which way. You know I don't have all my notes, but some of them have enjoined.

David J. Van Havermaat: If I could inject some detail if you want.

Richard E. Zuckerman: Well. Let me blow some smoke first *[laughter]*.

David J. Van Havermaat: Ok.

Richard E. Zuckerman: Now I've lost where I wanted to go because Ray interrupted me. [laughter]. But OK. So you have the. . . Oh I know I was going to say that you know there are a bunch of arguments being raised at the bottom by the litigants, which is due process, I'm entitled to be sued, not forced to an ALJ; Seventh Amendment jury trial argument; and the more important, appointments clause argument. The SEC has kind of prevailed. I think they've substantively prevailed. I might be wrong and so what's left is the argument about whether or not ALJs are constitutionally . . . well the way they're appointed and whether or not it violates the appointments clause. So, you may want to talk about first where do these ALJs come from to put into perspective how they get to where they are and how that may or may not violate the appointments

clause, which is really the fight. And then what these recent releases by the SEC are designed to, you know kind of like window dressing, to kind of make it look like we're trying to be fair. And there's a whole series of changes to the ALJ process themselves, which we may or may not have time to go into

David J. Van Havermaat: Can we just have a standing disagreement to some of these things?

Richard E. Zuckerman: Well yeah. It's not window dressing and but it is something else. But in any event. That's some background. But I think discussing where the ALJs come from put in perspective the root problem, which is the appointments clause.

John Birkenheier: Well this is all pending litigation so I have to be kind of constrained what I say about them. There have been about a dozen, say twelve or thirteen lawsuits, filed against the SEC challenging the constitutionality of the administrative proceeding process. And the way that, just so you know, the procedural postures is this. The SEC issues an order instituting proceedings. Somebody is named as a respondent. And they then sue the SEC simultaneously in federal court seeking an injunction, seeking to stop the administrative proceeding from going forward. As I said, there have been about twelve or thirteen of these filed so far. One curious thing about them, to me at least, is that a majority of these cases, the lawsuits, arise from proceedings which the SEC had the authority to bring prior to Dodd Frank. Because as I said a minute ago there are only a handful of proceedings since Dodd Frank that we have brought relying on that authority. So the argument conceptually has been around since 1934. But it's really now that it's being raised in any large numbers. The arguments that have been made in these lawsuits are, as Richard said, the appointments provision. That is, essentially the Constitution says there are officers, inferior officers, and employees. And the officers are constitutional categories of people. Inferior officers have to be appointed either by the President or by the head of the department. Employees can be hired by anyone within the federal government with the authority to make personnel decisions. So

the plaintiffs in these lawsuits, the people who are respondents in the APs, argue that the ALJs are inferior officers. But they are not appointed by the president or the head of a department and therefore they've been illegally appointed to their positions. And our position, which has been a subject of litigation and other lawsuits involving other agencies over the years is that the ALJs are employees and they're hired through the civil service process. They're hired, I believe, by our chief administrative law judge. And I think there are two paths that if they already are an ALJ then it's more just like a job application process. If they are not an ALJ, you know an ALJ with another agency, in other words. . . but if they're not an ALJ at all then they have to go through a more formal civil service for them to get their name on to the certificate of applicants to be considered for the job. But they're basically hired as employees.

Raymond W. Henney: *[Inaudible]*.

David J. Van Havermaat: They are paid more.

Raymond W. Henney: *[Inaudible]*.

John Birkenheier: I didn't know that. The other arguments that have been made are the two tier removal, in other words they can't be removed by the president, and that I don't fully understand the ins and outs of that argument. I mean I'm not saying that in a dismissive way, I just don't know the details of that. But there's a two-tier removal process which the ALJs are subject to. It is arguable and people have argued that it is unconstitutional. And then, as Richard mentioned, there's the argument that the respondents are being deprived of their right to a jury trial. The due process is being violated because the SEC gets to pick which forum to go to. Due process is violated because our discovery rules are narrower than those in civil litigation. And an argument that the ALJs themselves are biased. So far. But one thing as to the merits, Ray your point, in the cases in which the government has prevailed in these lawsuits, it has only been on jurisdictional grounds, but in order to get there, the judges have had to look at the merits of the arguments being made to make an assessment of whether there's a likelihood of success on

the merits. And so they've done that. So they haven't ruled on any of the issues, but they've analyzed them and kind of give an indication of where they might come out. The short of it is that the Seventh Circuit has ruled that the district courts and courts of appeals don't have jurisdiction until the administrative process is followed. I believe that is what the D.C. Circuit recently ruled also. The Second Circuit has, I don't think they've spoken on the merits, but they now stayed a case where the district court in Manhattan has ruled that the appointments clause was violated. A court in the Northern District of Georgia has ruled that the appointments clause was violated and therefore stayed one of our AP's and that matters is on appeal in the Eleventh Circuit now. So we've got Seventh in D.C. circuits have weighed in on and the Eleventh and Second are considering the issue.

Richard E. Zuckerman: The two-tier appointment business has to do with how do you get rid of an ALJ and whether or not, if you can't get rid of an ALJ as contemplated by the Second Amendment. Not the 2nd. (Laughter and Banter). You can't get right of them. The president can't fire them nor can the head of the agency. So if the president can't get to them directly then they've been appointed in violation of the appointments clause if they're inferior officers. And so the fight is what is an inferior officer? What is the characteristic of what an inferior officer does or doesn't do that would you know that's going to convince a court that there is or isn't an inferior officer? And everyone is saying they decide things that are of grave importance to the litigants. They are making decisions that establish liability. Obviously if you win you're not going to take up on appeal if you win that you were just exonerated by somebody that shouldn't exonerate you. So the argument is, is what they're doing the kind of thing an inferior officer of the government does? The litigants generally focus on the fact that they make adjudicative decisions that could implicate, you know, financially or otherwise, the people before them. Some of the cases say yeah that is what an inferior officer is. Others cut it finely and say well there are three things inferior officers can do. They can set policy, they can handle enforcement, they can adjudicate. The cases the SEC will rely on are the ones that say adjudication isn't an attribute of an inferior officer.

And then if you go to look at the Supreme Court has handled these in a variety of different ways. For example, there's a case called *Free Enterprise* a case called *Freytag*. There's a bunch of cases floating around where in all different kinds of ways, various ALJs and other departments of government have been challenged. But, it's not clear which way anybody is going to go. So although I thought Newman would go to the Supreme Court and I don't know if you guys are going to get to Newman or not it's more than likely that this issue will get to the Supreme Court. If you're a litigant now you know you'll raise the issues and see where it goes. But if you're a litigant you've got to raise all these issues because otherwise you'll find that you waived them and the client won't be happy.

Raymond W. Henney: Just sort of to set the landscape a little bit on what John was saying and then from the people outside the Commission. The sort of perceived pressure the Commission is under with respect to the use of AP. So John indicated that there were various circuits that have held with the SEC but holding with the SEC isn't that there's not an issue with the appointments clause. It's just that you have to go through the administrative process. They have a likelihood of success in that regard. So to the extent that federal courts have authoritatively in some sense ruled on this issue, it has been against the Commission. Then you have sort of the political aspect to it, which is kind of, so you have Dodd Frank that says you can bring what you used to bring in front of a jury now in front of these judges that you appoint and pay. Politically the SEC is the chief cop for the whole industry, for a large industry. And they're the ones who insure fairness. And it's the Commission that. . . and I know Felicia is going to comment on this our representative from FINRA . . . but it's the SEC puts a lot of pressure on industry arbitration. With respect to fairness and so forth. In industry arbitration, the litigants have a say in who's going to make the decision. If you have a jury trial you have some sort of say. The reason that this is . . . and I don't expect either John or Dave to have a comment on this. . . the reason that there's this political overture to this is that you have a case that was decided in front of a jury now being decided by the people the prosecutors pay. And in a free society there's just a high kind of issue with respect to that.

In fact earlier, just to add fuel to the flame, two of the Commissioners earlier this month issued a statement saying we should switch and stop trying to have these things decided by AP judges as far as the constitutionality. The federal courts should be deciding this issue. So you have an understanding. This is an issue that might affect your clients. But it's really kind of it is an institutional issue with respect to how various consistencies see the role the SEC.

Richard E. Zuckerman: Let me suggest that the Commission can. . . I don't know if they can retroactively move the issue but going forward they can, if the commission hires the ALJs, which they don't want to do. For whatever reason. The two reasons that I've heard, one you don't want to admit you did anything wrong because then that will spark a whole lot of litigation by a whole lot of people that it's either ongoing or supporters concluded assuming they preserve the issue. And number two . . . and I think this is slightly more subtle. . . is if the Commission appoints the ALJs then, are the ALJs going to reflect the politics of the Commission. Right now the idea would be that the Commission . . . the ALJs being appointed through the civil service system, you know, being Civil Service protected they're kind of independent make them kind of do the right thing. On the other hand if the Commissions hiring the ALJs, are you going to have a bunch of Republican type ALJs when the Republicans control the Commission. And then next year if the Democrats control the commission a bunch of Democrats that ALJs. And is that going to gum up the works even worse? So the courts have said well they haven't discussed the second point but the courts said well, the Commission fixes this, just hire them yourselves. But they don't want to do that. I don't know if these guys can talk about that or not.

Richard E. Zuckerman: I had told Elliot and Ray that I unfortunately I have to leave at Noon today so it's Noon and I've got to go. So I'll leave you with these words of wisdom don't believe anything I said.

Raymond W. Henney: Thank you Richard. David, you have just had to spend about forty five minutes next to Richard. Can you imagine being twenty years in office next door to him? (Laughter and Banter) John do

you want to talk about, I guess what my comments oh somebody has some, oh go ahead.

Audience Member: Are these cases that are pending . . . I know you referenced how it was expanded under Dodd Frank, but if they're decided adversely to the Commission, are they simply this member of the whole administrative process, are they for both industry insiders as well as people outside the industry?

Raymond W. Henney: If these judges are ruled constitutionally and let them come in I think you'd probably like to hear from them, but it would be a crisis. It would be a crisis was respect to that aspect.

Audience Member: I don't recall it seems like people in the industry kind of waive their rights to things decided outside the industry.

Raymond W. Henney: Right. The industry people will probably be the A.P. process with respect to the industry was historically like this before Dodd Frank. One would suspect that the Commission will be able to defend the continued use of that no matter what the ruling is with respect to the appointment issue. But there's a question. There is a question about that. And if you got it can you guys comment on it?

David J. Van Havermaat: No, I can't really comment on that.

Richard E. Zuckerman: Yes.

Audience Member: Earlier you mentioned due process and gathering of evidence. And they were talking it sounded like cases that only involve possibly not FINRA related?

Raymond W. Henney: Yes.

Audience Member: When FINRA gets involved, if FINRA I'm not even sure how they are classified whether they're a government organization or not but they don't have subpoena power. . . how do you gather

evidence and have it end up in front of the administrative law judge. And no according to FINRA type rules rules where it's just so difficult to get your evidence into play.

Raymond W. Henney: Well I think what you're asking is are the respondents so handicapped in the AP process, that it's difficult to present evidence. And I think John was trying to and Dave were trying to suggest that there are avenues and defendants are able to put together quite a bit of evidence. For instance John was talking about. . . Most of the witnesses typically are people affiliated with the respondent. You know and to the extent that it is . . . and John I'll let you comment on that . . . you know to the extent that its customer related and for an industry person if you have no more access to that than you do in an arbitration. So that's why there is this sort of fold over. When you're talking about industry these challenges, and when Richard was talking about real people this is his cynical way of talking about non-industry people, these challenges, these really vigorous challenges have come through people who, not all of them, but a lot of people who are not traditionally in the FINRA world.

Audience Member: Well what I'm trying to get at is that when you go and have a FINRA issue, FINRA is an outgrowth of the old NASD, people now who will be old and I ask you what why the name change. They find there is a relationship with the former Bernie Madoff No one in their right mind wants to get involved with that. So it's hard to get someone to come and give testimony. Or go to Chicago or Washington. And they don't want to have any dealings. And so you are now, I don't know how you call it, the well is poisoned or the whole situation starts to unravel as to trying to gather evidence, in some sort of defense.

John Birkenheier: Well that's right. If I understand this comment, the SEC's rules of practice provide respondents the right to issue subpoenas to require the attendance and testimony of witnesses and the production of documents. They have to, the respondents and the staff have to request the ALJ to issue a subpoenas so there's a check, so they provide a

check and make sure the subpoenas aren't too broad. But you can compel the attendance of witnesses.

Raymond W. Henney: John do you want to talk about the new proposed rule changes?

John Birkenheier: Sure. The SEC within the last couple weeks of this year has proposed changes to the rules of practice in effort to I think modernize and add some flexibility to them. Keeping in mind that these rules were. . . you know you read them and they read a lot like the Rules of Civil Procedure that were in existence when some of us in the room were probably in college maybe. But not as they are now. And the short of it is the rules will allow I think either three or five depositions per side depending on the number of respondents. And will extend the time periods under which the ALJs have to issue their initial decisions. I think those are the core of the new proposals.

Raymond W. Henney: Any other comments on the AP process gentleman?

John Birkenheier: Just to finish up on the process part of it. You know if you're if you're litigating an AP. Be prepared to be prepared to go to hearing in four months because under the three hundred day deadline the typical timeframe for the hearing is four months from service of the order. There will be a two month briefing period. And then the administrative law judge has roughly four months to render decision and their decisions are usually very detailed. They issue, sixty, seventy, eighty, longer, page decisions and the factual record.

Raymond W. Henney: Let's move on if we could to recent SEC enforcement litigation and John did you want to.

John Birkenheier: Yes sure. We're short of time. I'll be brief about this. You know so far for fiscal 2015. We've probably got we've gotten approximately fifty outcomes in litigation I think. We've won 23 summary judgment motions and we've had 19 trials. Trials before juries

or in administrative proceedings. In court we've gotten favorable verdicts in all five of the cases that we tried to juries. And in the APs in which rulings have been issued we've prevailed in twelve and in two of them the respondent prevailed and the charges were dismissed. So that's sort of an overall in terms of outcomes and numbers. I think that you know, that we had more trials last year in 2014 than we've had this year by a little bit. I think the last not this past year but the year before was probably an outlier in terms of numbers. But in terms of. . . one comment that I'll make is that when you see articles commenting about the SEC success or failures in litigation. I'd ask you to keep in mind those articles generally focus on trials. And I think it's helpful to keep in mind the summary judgment motions as well as the motions to dismiss because if you look at 2015 as an example almost fifty percent of the cases which were resolved were resolved by our winning summary judgment motions and I think the only way to get a full picture is to look at both sides of that.

Raymond W. Henney: So Richard talked about *Newman*. *Newman* is the second Circuit case concerning criminal prosecution for insider trading in which the defendants were found guilty. But was reversed as if I'm correct, and it was reversed. These were tippees and as I understand it the standard that the second circuit is imposing is that the tippee who receive the information has to know that the tipper or got a personal benefit. In what the personal benefit was by providing the tip. That has had a lot of ramifications in the insider trading defense world and if you would like to comment on it.

David J. Van Havermaat: Sure. *Newman* and its aftermath are murky frankly. Newman, to follow up on that discussion, involved insiders to publicly traded companies who tipped to analysts' information about their most recent quarterly earnings. And from the analysts who receive the information, there were chain of people that received it, the analysts tipped it to other analysts. It went through, in some cases one other person and in some cases two other people and the information eventually made its way to the hedge fund portfolio managers, Todd

Newman and Anthony Chiasson. And one of the important factors in the Newman decision is that these tippees were several layers away. They are what are sometimes called remote tippees. They're not the first level person that had contact with the person that was disclosing the information and there are two holdings that came out of *Newman* that are particularly relevant. One is that to be liable, a tippee has to know both that the information, the initial inside information, was disclosed in breach of a duty and that the tipper did so for his or her personal benefit. I think probably the most interesting part of the decision was the second holding that had to do with what type of personal benefit could be sufficient to establish that the personal benefits prong has been met. And the *Newman* court had various language like the personal benefit must be quote "of some consequence," that other things would suffice such as a pecuniary gain, or reputational benefit that would translate into future earnings, essentially a quid pro quo. But there's other murkier language that's included in *Newman* and some of the subsequent cases and I'll read the language here that the *Newman* court used. One of the things you look at if there's no direct quid pro quo if there's no, "I'm going to trade on inside information and give you one hundred thousand dollars in exchange for it," look to whether there are "meaningfully close personal meaningfully relationship that generates an exchange that is objective, consequential and represents at least the potential gain of a pecuniary or similarly valuable nature." The net impact of the *Newman* decision is probably to make it more difficult to bring cases against remote tippers because any remote tippers going to say wait a second, I had no idea you're talking about information that was conveyed from an insider to someone that I'm three levels removed from. And I had no idea what the personal benefit is there and because you can't prove that I didn't insider trade. The *Newman* decision has been softened a bit by some subsequent decisions. There's a Ninth Circuit decision called *Salman* that came out this year. It had to do with family members. It was a brother that worked with Citigroup health care or investment banking group or something like that, who tipped his brother regarding inside information about that he had learned through Citigroup. The brother tipped his brother in law and essentially said, "Hey trade like me, we are going to make a lot of money. Things will be great." And it was a very close family. The

interesting thing about this is going back to the question of what constitutes a personal benefit and the meaningfully close personal relationship. The courts that have looked at this, have really dug into what is the relationship between the tipper and the tippee. And I think you can expect because cert was denied by the Supreme Court, that this is probably going to continue. And that the factors that are mentioned by courts are quite interesting, as shown by in the *Salman* case. It was at least important for the court to mention that the, tipper brother quote "loved his brother very much" in terms of determining what is a meaningfully close personal relationship. It went so far as to cite things like the there was I think it was the Tipper's wedding if I'm not mistaken, and the tippee got up and made some toast where he said "Such a great guy. He's one of the most generous people I've ever known" and the groom who was being toasted started to break down and weep. I mean those are the sorts of things the courts are looking at. So I think you can expect that in investigating these cases that those are the sorts of questions that are going to have to be asked. How close is the personal relationship here? Is it meaningful or is it more casual? I think one of the lessons from the Ninth Circuit case *Salman* is that probably it's easier to bring a case involving family members than friends, but again it really depends on the facts of each case. For example, is there a history of personal favors? I know the *Newman* court, for example, expressed some skepticism about, if they go to the same church or their alumni of the same school that's more of a casual acquaintance and that may not reach the level of a meaningful relationship. Other cases may muck things up even further. There was another case out of the Southern District of New York called *Riley* is "If a tip maintains or furthers a friendship and is not simply incidental to the friendship," that's circumstantial evidence that it's more of a quid pro quo relationship. So your guess is as good as mine is what furthers a friendship versus being incidental to a friendship, and what is meaningfully close in terms of relationship and what isn't. But I think that the take away here is that we've always looked at the relationship between the tipper and the tippee in these cases. There's going to be a lot more digging because the courts have said this is relevant in determining whether there is a sufficient personal benefit to satisfy the prong of the insider-trading allegation.

Raymond W. Henney: There doesn't seem to be any hesitation by the commission caused by the *Newman* case as far as public statements and directives that have been made public. *Newman* is just, puts a little bump for the commission but it doesn't seem to have a major impact with respect to the commission's policies and enforcement procedures regarding insider trading, Correct?

David J. Van Havermaat: This is a decision that's made on a case by case basis. There's not really anything that we could say about it. And that's the answer. We're aware of it. We're aware of the constraints that we're operating under and as I said, I think we recognize it makes it more difficult.

Raymond W. Henney: You know I don't mean to be like Richard and ask you questions that you can't answer. He left you, really shouldn't have, although I will say there is sort of a sadistic pleasure in doing it with do that. Why don't we move to our next topic, which is the SEC whistle or whistle blower program in the two thousands.

David J. Van Havermaat: Sure the whistle blower program is now, I think just over four years old, it was established by Dodd Frank also. It's the carrot approach to helping the Commission staff investigate possible violations of the securities laws. Just to summarize briefly, the whistleblower provisions allow the Commission to pay and award between ten to thirty percent of amounts collected to eligible whistleblowers who voluntarily provide what's called original information about securities law violations. It has led to a successful enforcement action that results in monetary sanctions of over a million dollars a couple of key points here. Original information can be either independent knowledge or independent analysis. Typically, it will be independent knowledge of someone within the company who has information that is particularly helpful. Eligible whistleblowers, generally, are not compliance officers, attorneys, auditor, senior enforcement personnel things of that nature. Well there is an exception, if one of the ineligible persons first reports it to the company, the

company does nothing the reporter waits one hundred twenty days, and then reports it to the Commission. There is the potential of a whistleblower award being appropriate there. No one is entitled to a whistleblower award it is in the discretion of the Commission. There is a whistleblower committee that reviews all of the reports are all the tips that come in. This fiscal year two thousand and fourteen we had thirty-six hundred tips. Mostly in the nature of corporate disclosures, financial fraud, and things of that nature. So far in history of the program there have been twenty awards and they've totaled over fifty million dollars. And I think one of the awards in particular was in the tens of millions; there was one particularly substantial award. The most the recent topics in the whistleblower realm have to do with retaliation cases they're going two that the Commission has brought within the last year to year and a half. One is called *Paradigm Capital Management*. There was a whistleblower who was retaliated against and that is prohibited by the Exchange Act rules that implement the whistleblower provisions and that entity, that violation was specified in the order that the Commission brought. The more interesting one that has generated more discussion was just in April of this year. It's a case called *K.B.R.* One of the provisions of the SEC whistleblower rules has to do with retaliation and says specifically, "No action may be taken to impede an individual from communicating directly with the SEC staff about a possible securities law violation, including threatening to enforce a confidentiality agreement". *K.B.R.*, as part of its compliance program, would get complaints from employees about what they viewed as possible ethical breaches or illegal conduct by the company or by its employees and *K.B.R.* had a process by which it would conduct an internal investigation. When those complaints came in, in connection with the internal investigation *K.B.R.* required employees that it interviewed to sign a confidentiality agreement that stated that "I understand that I'm prohibited from discussing the particulars of this interview or the subject matter discussed without prior authorization of our law department. I understand that if I disclose these matters without authorization that may be grounds for disciplinary action up to and including termination." And the Commission brought an action earlier this year because of that language, which chilled the prospects of whistleblowers coming forward

to report potential illegal content to the Commission. The interesting part of that case is that was a standalone case. There was no underlying violation that was alleged by the Commission. It was solely based on this rule, it's Rule 21F-17 of the Securities Exchange Act. There was no other violation of the securities laws, it was simply a Rule 21F-17 Action that was brought in that realm. In that case the company paid a nominal penalty and agreed to restate its confidentiality agreements to make it clear that anyone that wanted to could go to the to the SEC or to criminal authorities to report any wrongdoing.

Raymond W. Henney: Let me just interject is that is a very significant case particularly for practitioners. So it's likely the particularly in the securities industry. You have policies and procedures that preserve confidentiality U.S. Regulation S-P issues, you have all kinds of issues with respective competitive advantages and so forth. And you have very strict confidentiality provisions that would read literally prohibit whistleblowing, but you're not thinking about that because you've had these for years and it's very important. This case really was sort of a wake up call for in-house lawyers to dust off their policies and take a look at whether or not they have those kind of typically broad in the companies interest confidentiality provisions and make sure that they comply with what Dave was in mentioning, concerning allowing employees not having this chilling and fast ploys its understanding that they can still make complaints to the SEC.

David J. Van Havermaat: Yeah. And Commission speakers have come out and said essentially that it's recognizing that there are going to need to be restrictions on trade secrets and things of that nature for example. The key,though, that it has to always be permissible for someone to be able to report possible securities law violations to the Commission.

Raymond W. Henney: Any questions on that. We've only got a minute. Dave, I'm sorry to do this to you.

David J. Van Havermaat: Cooperation, real quick.

Raymond W. Henney: If you'd be cooperate enough to talk about cooperation that would be great.

David J. Van Havermaat: I think there are a couple varieties of cooperation agreements that the commission can enter into. The most commonly by far is simply a cooperation agreement. There are others that require pretty extraordinary circumstances, a deferred prosecution or a non-prosecution agreement. But the vast majority of what you're going to see is use of cooperation agreement that's with the Division of Enforcement, that this isn't something that requires Commission approval. It's essentially an agreement that if you or your client agrees to abide by the requirements of the cooperation agreement which, can be anything from testimony to helping us sift through documents to putting together a spreadsheet of explaining transactions and things of that nature, that the Division will recommend to the Commission that's a cooperator receive credit for its cooperation in the investigation or litigation. There are no promises given but I can tell you that the question of anyone that's has this face them is, "Is this going to be worth it to me?" It is. There are meaningful credits given for cooperation and, there are times where the division would recommend not bringing charges against the individual if the cooperation is high enough quality. There are other benefits to cooperators, potential benefits, again none of this is guaranteed, of reduced penalties that happens in a good percentage of matters that involve cooperation agreements, and also the possibility of a reduced suspension or bar. If you're a cooperator that's coming in and, in connection with your cooperation, you're recognizing the wrongfulness, things of that nature, those are factors that go to whether a bar is appropriate and, if so, how long of a bar. The fact you're coming in and acting as a cooperator is an important factor in the relief that we might seek. Again none of that is guaranteed. But obviously the Commission has a vested interest in making sure that the credit that it's giving is meaningful otherwise the program would not survive.

Raymond W. Henney: Any questions for these gentlemen. Thank you so much, gentlemen.

Elliot Spoon: We would also like to thank Ray for facilitating that panel. At 1:00 o'clock we are going to have a very important luncheon panel. Enjoy your lunch.

Lunch and Feature Panel: LARA Regulators on the New Proposed Rules for the Revised Michigan Securities Act

Elliot Spoon: Luncheon panel. Back in the planning stages for this year's conference, I talked to someone I knew at State and said I would really like a speaker from the State during lunch to talk about the status of the rules under the Michigan Uniform Securities Act, and a week later he called back and said I've done a little better. This is such an important topic that we didn't think one speaker could cover it, so we'll have four to address this issue. And so, hence we now have a luncheon panel covering every aspect of the rules. So I take a great deal of pleasure in introducing Lindsay DeRosia, Steven Bray, Jason Kraft, and Stephanie Fleming from the Department of Licensing and Regulatory Affairs. I am a little bit biased towards this panel because Lindsay and Steven are my former students. Take it away folks.

Lindsay DeRosia: Thank you and good afternoon, I want to thank Professor Spoon and Ray Henny for putting together, once again, a fantastic seminar and we really appreciate the opportunity to speak about the status of our long awaited rule set. First, as any good regulator needs to I must give the disclaimer that opinions expressed are my own and not necessarily those of the Bureau or Department. That probably applies to everybody. As most of you are aware, back in October 1 of 2009, the new Michigan Uniform Securities Act went into effect, and yes your math is right that was six years ago, not too long ago. At the time the act was implemented we created transition orders, which would temporarily address what would be covered by the rulemaking process. Those transition orders are still in effect right now but it's a very high priority of the Department right now to get the rule set promulgated. And so we are very actively in the process, we've done a lot of drafting, and they are in the rulemaking process at this point. I'm looking at Stephanie,

Stephanie's at the Department level, she's our in house expert on the administrative rulemaking process, so that's part of the reason we need a fourth is I could not speak to that very well. So we don't have a copy of the rule set here today. Like I mentioned we are still drafting it so, there are some changes going back and forth a little bit but there are generally areas that are pretty solid in the rules, so what we wanted to do was, article by article list the rules that will probably be in there and give a high level overview of what's going to be included in those different areas. So, I'm going to start speaking on articles two and three, and articles two and three cover product registration, product exemptions, and product notice filing. So I'm not going to go through each of the rules but this is essentially the rules that are going to be included in that area. I'm going to highlight a couple of them that I think will be of interest. Rule 2.1 will cover the not-for-profit securities exemption. Currently in the act, there is an exemption for not-for-profit securities. Church bonds is what it's commonly referred to. In the act it creates an exemption but allows the administrator by rule or order to clarify the terms of the exemption. Currently in transition order five we actually require a registration for these filings unless it's less than 500,000. So by rule right now it's proposed to adopt something very similar, where less than 500,000 there'll still be a self-executing exemption. If it's above 500,000 what they're looking at at this point is going to be getting an exemption order from the administrator. And the rule in that area would incorporate the NASAA statements of policy for church bonds. The next rule I wanted to highlight would be the bad actor disqualification. Similar to the developments in federal legislation, we've potentially created a rule that would disqualify certain persons from utilizing exemptions under the Michigan Uniform Securities Act if they have been subject to certain disqualifications. And that would require some factual inquiry by the issuer typically as well. The state securities registration and notice filing rules, essentially what this covering would be a depository for the state securities filings. Probably any of you who practice in the area know we don't really have a system similar to EDGAR for the state securities filings, and so what NASAA has created is called EFD, electronic filing depository. The goal is to get a lot of those product filings to be made via that system. So the rule would allow for that

system to capture the electronic filings for the State. The goal of the rule is to get a lot of the product filings there, right now it's only capable to receive Form D filings, so that's what we're looking to go towards. Rule 3.5, anyone in the product review area probably realizes when they go through the state review of the products, they typically follow the NASAA statements of policy, so what we wanted to do by rule was incorporate those and adopt those by rule. This rule, the last draft that I have seen also incorporates a suitability recommendation for issuers, so that's something to look out for as well is actually incorporating that by rule. That's all I have for the two and three, I don't know if there's any questions on those areas. Yep?

Audience Member: Are you trying to go with any guidelines regarding fiduciary versus suitability issues that are out there today?

Lindsay DeRosia: Are you about talking like broker dealer IA context?

Audience Member: Yeah.

Lindsay DeRosia: I don't know, like as we'll talk about in the article four rules, we do adopt the prohibited practices for both investment advisors and broker dealers, I don't think there's going to be anything groundbreaking as far as application of fiduciary to broker dealers, it's basically a model of what the other states currently have in those areas.

Audience Member: Are you changing your oil and gas rule 2.4 from what was there before?

Steven Bray: It should be largely similar.

Lindsay DeRosia: Yeah, I think that one.

Steven Bray: As I recall it is largely similar if not identical to the exemption under the transition order.

I want to start by thanking Professor Spoon for having us here today. It wasn't that long ago that I was a law student out there, sitting, watching all these people. Man this is kind of fun stuff. I hope he has a miserable Saturday though because if you can tell by my tie, I'm a big Spartans fan, I'm wearing a beat Michigan shirt under my suit. Go Green. Thank you. So Jason and I split up article four, it covers broker dealers, investment advisors, investment advisor representatives, and MIMs, Michigan Investment Markets. The proposed rules are all on the slides, I've got 4.1 through 4.12 here. Just like Lindsay did we're not going to cover all of them. By and large they're intended to keep current practices under the transition orders in our existing rule set in place. Some of the highlights we're going to discuss in more detail, there are some changes. Here's the second half of the set that I'm going to cover a little bit. We're going to cover registration, notice filing for investment advisers and broker dealers. Minimum financial requirements for each. Record keeping requirements for each. Their exemptions from registration from certain broker dealers, certain investment advisors, their employees. I believe was it Shane mentioned the M&A broker rule earlier? M&A broker exemption? It's not reflected up here, you'll notice that, it's been a recent development for us. I can tell you I've looked at a draft for one, I've edited a draft for one, and it may or may not be included in the final rule set. Look for the comment period, you'll have an opportunity to say whether or not it should or shouldn't be in the rule set

Lindsay DeRosia: But the point that you've seen, just to clarify is similar to what NASAA has recently adopted?

Steven Bray: Yes, does everyone know what NASAA is? I mean aside from a space program? The North American Securities Administrators Association. That's a group of state's provincial securities regulators and regulators from Mexico. We promulgate model rules so we have some modicum of consistency across the states. It's not in there right now, it's not up there. I would anticipate that it will be. Like I said look out for comment period and if you want more information look at NASAA's website. They have a model rule, which we're basing our rule on. It'll give you some information there, some comments from the public that I

think are helpful in further explaining the rule. One of the highlights that's going to be different from current practices is we're going to slightly alter transition order six, for those who are familiar with it. The private fund adviser exemption. After Dodd-Frank there were some changes and I know a lot of states had made changes, NASAA proposed a new model rule, and this rule is largely based on that. It creates a registration exemption for advisers to private funds who meet certain conditions. You're not disqualified from utilizing the exemption under the bad boy provisions of 506(d) of regulation D and you file with the state everything that you are required to file with the feds. Private advisers that advise one or more 3(c)(1) funds have certain additional obligations. At least some document disclosures, you can only have qualified clients, as opposed to qualified clients or accredited investors as shareholders of the fund. That's going to be one of the bigger differences between this rule and transition order six. And an annual audited financial statement requirement. Now what's a 3(c)(1) fund? Look at the investment company act of 1940. 1940? Yeah. Section 3(c)(1), generally speaking is no more than 100 equity investors in the fund and you don't propose to engage in a public offering. There's more detail to it, like I said, look at the rule. There's a grandfathering provision for funds that existed prior to the rule, we're cognizant to the fact that there are going to be certain funds with accredited investors as opposed to the higher standard for a qualified client. If it meets certain conditions you may be able to be grandfathered. Okay? A lot of people I think are curious of the MIMs. A MIM is a Michigan Investment Market, it was created by the legislature in 2014. I believe it's intended to create secondary market liquidity for securities issued pursuant to the Michigan invest locally exemption or the intrastate crowd funding exemption. It's essentially a broker dealer, it's exempt from federal registration, this is an excerpt from the definition. Creates a market or exchange at which transactions are sold or offered for sale in the state under the intrastate offering exemption. The statue gives us authority to make rules and essentially we intend to treat them as broker dealers because that's what they are. The registration process will be more fully flushed out in the rule. But it is something we are looking at doing. Exam requirements for investment advisors and IA reps. One noticeable difference here is it clarifies that a

sole proprietor investment advisor does have to meet the same exam requirements to qualify for the license as an investment advisor representative does. Currently under the statute and transition orders that's not very clear. And there is a legal question as to whether or not a sole proprietor IA has to take any exam to become registered. This will clarify that he or she does. Custody. Largely it's going to be the same. Comply with the SEC custody rule. Again, we're departing from transition order six. Currently, if you're an advisor to a private fund that only has accredited investors, you can have custody of that in Michigan, or custody of client funds and securities. Under the proposed rules, you're going to have to comply with the custody rule as is, or otherwise have an order of the administrator allowing you to specially have custody of funds. Minimum financial requirements for investor advisors. It's largely the same, there are going to be some different ones, I'll look at my notes here. Investment advisors with custody will need to maintain at least 35,000 dollars in net-worth. IAs with discretionary authority must have at least 10,000 dollars of net-worth. And investment advisors that accept prepayment of 500 dollars or more per client, more than six months in advance, will be required to maintain a positive net-worth. There are no other requirements in the rule that I am aware of. Any questions on that at all? It will be a slight departure out from the transition orders that currently just require a positive net-worth for any investment advisor. One of the other ones that we think is kind of a highlight and its a little different, its been a big push for NASAA I know, for FINRA for the SEC is business continuity and succession planning and having plans in place. I looked at the investment advisor association's website and 97% of SEC covered investment advisors have one of these. And speaking with one of our examiners at the state level they said maybe 10-20% of the time they see investment advisors with these. So this will be a bit of departure, but in talking with Jason one of our examiners, for years has been recommending for best practices that investment advisors have these. Especially at the state level where many of them are small, one man shops, it can be very important in the case of a death, a disability, a emergency, you know what's going to happen to client funds. Jason was telling me a horror story about one IA had passed away and the spouse just dropped everything off after hours at their

office. What do you do with it? So it's an important topic that I think will be important to cover. That's my half. I'll pass it on to Jason. Go Green.

Jason Kraft: Thanks Steve. So I have the remaining of the rules under section four. Rule I won't go through each of these in-depth kind of the highlights out of all of these. Rule 4.23 essentially the books and records to be maintained by investment advisors. That's essentially model language that we have in the current transition orders on that subject. Rule 4.24 the prohibited practices of investment advisors and investment advisor representatives. Rule 4.25 goes through investment advisor contracts and the required language in those contracts. Rule 4.26 outlines dishonest or unethical business practices of brokers dealers and agents. In rule 4.27 is a use of senior specific certifications and professional designations. Under rule 4.24 it's the prohibited practices of investment advisors and investment advisor representatives. And this adopts an existing NASAA model rule on this subject. Essentially this rule states that investment advisor and investment advisor representative shall not engage in prohibited, fraudulent, deceptive, or manipulative conduct. It provides specific examples of such prohibited conduct. Obviously there is a laundry list of such conduct in the proposed rule: borrowing money or securities from a client unless that client is a broker dealer, loaning money or securities to a client unless the investment advisor is a broker dealer, bank, or other financial institution engaged in the business of loaning funds or to the client is an affiliate of the investment advisor, charging a client an unreasonable advisory fee. Under rule 4.26 again this is the rule on dishonest or unethical business practice of broker dealers or agents. Again this adopts an existing NASAA model role on this subject. Something to keep in mind, this conduct, the conduct set forth in this rule isn't all-inclusive. Engaging in other conduct such as forgery, embezzlement, non-disclosure, incomplete disclosure, a misstatement of material facts, or deceptive practice shall also be grounds for a denial, suspension, or revocation of registration. Same with the investment advisor list of prohibited practices there's a laundry list of items under this one that I won't go through for purposes of time. But they can include inducing trading in a customer's account which, is excessive in size or frequency in view of the financial resources

and character of the account. Recommending to a customer the purchase, sale, or exchange of any security without reasonable grounds to believe that such transaction or recommendation is suitable for the customer based upon reasonable inquiry concerning the customer's investment objectives, financial situation, needs, and any other relevant information known by the broker dealer. Guaranteeing a customer against loss in any securities account of such customer or any securities transaction affected by the broker dealer with or for such customer. So those are the proposed rules in section four under Article 6 we have essentially two rules. I'm sorry, there's a question in the back.

Audience Member: In that prior slide, if you were to find any of those problematic issues, do you get a tip from the public and then do you go get a subpoena or do you call FINRA or do you call the SEC? How do you enforce issues that you uncover?

Jason Kraft: Obviously it's a case-by-case basis. It just kind of depends on who the registrant is. I work in the exam and audit division.

Lindsey DeRosia: Yeah they could come from a number of avenues, we get, I am a manger of the investigations area so the exam teams out there continuously conducting examinations. So if it's something they uncover during the exam process, depending on the severity of might be something that's correct through the deficiency letter. If it's severe enough that warrants sanction then it may get referred for enforcement action. So we would handle those typically in our own agency through the administrative process, cease and desist order. You know avenues that the Act allows for. We could potentially work with the SEC but we wouldn't typically refer that out.

Audience Member: But you have the power to go to the Ingham County Courthouse and get a subpoena or are you like FINRA?

Lindsey DeRosia: Yeah well we do have, well we are a government agency so we do have the authority to subpoena and then if we need to enforce the subpoena we need to go through our attorney general's office

to go to Circuit Court. So we do have remedies available through the administrative process similar to the SEC or through the court processes. If we go through the court process, we bring in our attorney general's office. But yeah we do have subpoena authority but as a licensee and in Jason's area he's talking regarding licensees a failure to cooperate or refusal to cooperate with an examination could result in immediate suspension of a license.

Jason Kraft: So under Article 6. The two rules, 6.1 is a rule on interpretive opinions rule 6.2 is essentially outlines some rules on copy and certification fees under interpretive opinions essentially an opinion may be issued pursuant to section 605(4) of the securities act. Essentially anybody interested in submitting such an opinion would essentially follow these procedures outlined in this rule in order to submit such an opinion to our office.

Lindsey DeRosia: So that kind of covers substantively the rules. As I mentioned before Stephanie is going to go over the rule making process and of course these would all be drafts of rules and the administrative process allows for comment period and after, for people in the industry to provide us insight onto why a certain rule may not be a good idea and their commentary and so Stephanie's area will cover when that comment period comes into play and all of the different I don't want to say obstacles because I hear there is a transcript but procedures.

Stephanie Fleming: So I get to be the one that talks to you about how and why it takes so long to get rules promulgated in Michigan. First it's the Administrative Procedures Act that lays out the procedure for rule making in Michigan. It requires that rules have statutory authority provided in the act. And that statutory authority can either be, it has to be very specific based on this new current administration. So it could say the department shall promulgate rules or may promulgate rules regarding blah blah blah. Then if there's a general provision that says the department can promulgate rules to implement this act or administer this act in order for the department to do so they really need to have, well there has to be the topics spoken to in the act itself. So if there's no

continuing education we can't just say oh well we have rule making authority so now we're going to make a rule on administration or on continuing education, we can't do that. So then section 39 of the Administrative Procedures Act requires a request for rulemaking so that's the first step. As an agency they need to figure out why the rules are needed if there's any contradictions with federal law, or other state law and they kind of do research and lay out what the procedure is. Then that is submitted to the Office of Policy and Legislative Affairs who does the initial review of every document that we send to, through the rule making process. Once they have reviewed the request for rule making they will then forward that to the Office of Regulatory Reinvention. Office of Regulatory Reinvention has attorneys that work there and so they look through the requests for rule making make sure we have authority for the rules that were saying we're going to make. And whether or not we can proceed really. So then once it's approved by the Office of Regulatory Reinvention, it's sent back to the agency and the agency can now begin to draft rules.

Lindsey DeRosia: So we have passed that step.

Stephanie Fleming: We have passed that step, it just took a little while. So we have drafted rules we actually work very closely with the securities committee from the Michigan state bar and back and forth and had a couple meetings with them to get some input and so the first, the draft is submitted to the Office of Policy and Legislative Affairs. They review it for formatting issues. So they don't really look at any legal substantive anything. So if there's a period missing they'll try to catch it and send it back to us. So we've had a lot of back and forth when some small technical

Steven Bray: Active versus passive sentences, semicolons versus commas, any number of grammatical issues.

Stephanie Fleming: Capitalization. So that has been our barrier thus far to getting those. So once the Office of Policy and Legislative Affairs reviews the actual draft rules and approves them. Then they forward it to

the Office of Regulatory Reinvention. Office of Regulatory Reinvention reviews it for substantive problems: do we have authority for that specific rule, are we overreaching, does it not make sense, does it yeah, does it make a weird interpretation or something. So they actually look at the substance. So then once the Office of Regulatory Reinvention looks for the authority basic legal principles and they approve it. Then it will go to the Legislative Service Bureau. The Legislative Service Bureau has one person who works there who reviews every rule, proposed rule for the state of Michigan and her name is Marge. And she likes a red pen. So she also reviews for formatting to make sure that they comply with the formatting requirements for the Legislative Service Bureau. And she'll mark with her red pen all over it and send it to the department interoffice mail to have those corrected. Once the Legislative Service Bureau has gone through the approval you've made all the corrections, then it goes to the Regulatory Impact Statement. So the agency has to, based on section 45 of the A.P.A. has to complete a form that requires a ton of information. And a lot of it is in regards to small businesses are there prohibited prohibitions against small businesses, is it going to make business not flourish in the state of Michigan. And also if there's any conflicting information like Federal or state and if there is why are we doing that. So that does take a while then once the Regulatory Impact Statement is done by the agency once again it's sent to the Office of Policy and Legislative Affairs where they review once again for grammar, typographical errors. And then once they approve it the Office of Regulatory Reinvention who looks at it substantively. And then questions where we received information and all of that. Once that Regulatory Impact Statement is approved by the Office of Regulatory Reinvention the agency gets a go ahead to do the public hearing. So the public hearing is pursuant to section 41 of the A.P.A.. And it requires a notice be placed on the Office of Regulatory Reinventions websites, our, the agency's website. And it has to be provided in three newspapers of general circulation. So one west, one east, and one

Steven Bray: One in my homeland of the UP.

Stephanie Fleming: The Mining Journal.

Lindsey DeRosia: So Stephanie are there certain newspapers that are typically used for that process?

Stephanie Fleming: There are, at least our agency, I think you can do any widely circulated. And I was trying to think right before I came up on which ones, and the lack of sleep has been to me so we do Muskegon. The Muskegon Chronicle, The Mining Journal, and Oakland.

Steven Bray: The Oakland Press.

Stephanie Fleming: That's it I think. So yeah. And then, the notice has to be published, less than sixty, not less than sixty days, but more than ten days before your actual public hearing. And then the Administrative Procedures Act lays out all, what all has to be in the public notice. And then the Open Meetings Act requires, sets forth all of the requirements for how a public hearing is to be compelled or done. Then we also within the public hearing we always have a transcriptionist there. So we don't have to bring our tape recorder and type it up ourselves. And there's sign in sheets. So when this comment period comes typically there is check boxes: do you oppose it, do you support it, do you have questions, do you want to speak on it. And that will give you the opportunity to do that. Then.

Lindsey DeRosia: Stephanie if I can back up does it have to be spoken, I mean can people show up with written documentation?

Stephanie Fleming: People don't have to show up at all. You could submit a written documentation that's part of the public notice. So it will have an address, a contact person, and you could submit that via e-mail, mail, or come to the public hearing and hand it. One public hearing that I did, an individual had a fifteen-page dissertation who read the entire thing also during the public hearing. So either or. Unless you want to do highlights. So then the JCAR report. The JCAR report is really the compilation of everything that the agency has done. So it will be after

the agency reviews the comments from the hearing, makes their determination on are they going to agree with the recommendation are they not going to agree to the recommendation. And then they will put that into the draft rules and all of the information. So JCAR report includes the strike bold rules, the clean draft rules, hearing sign in sheet, the transcript. It includes all the questions and comments and the agency's responses and then the affidavits of public hearing. So then once it is sent to the JCAR, which is the Joint Committee on Administrative Rules. Then they can, they have fifteen session days to take action on the rules and they can object for only seven reasons and those are listed in your thing. If they object the rules are on hold. The committee members have fifteen more session days to introduce legislation. And introduce and pass bills that would remove the authority to lay effective date of rules, resend rules upon effective date. However almost, well, ninety percent of the rules, most rules they wait out there fifteen session days. Unless the agency asked for a waiver, but in order for a waiver to be approved the JCAR actually has to meet and agree with a majority, concurrent majority that they're going to approve the waiver. So sometimes that's very difficult to get. And then the final step. They are filed with the great seal. So once they're filed with the great seal a certificate of adoption that's been signed by the department director also is included in that. And it will become effective whenever the agency wants. If they don't specify a period then it is affective as soon as it's filed with the Secretary of State. One minute over.

Elliott Spoon: Are there questions for the panel?

Audience Member: When do you think all of this will be done?

Stephanie Fleming: Well the department’s goal is to have it completed within the first quarter of 2016. So we're working diligently on getting that done. There's always other things that come up but that is our goal.

Lindsey DeRosia: I can reiterate that for this department. This administration has a very high priority to get these out.

Stephanie Fleming: Yes.

Steven Bray: I think I saw another hand in the back.

Audience Member: In the past when you have set goal have you always met them?

Lindsey DeRosia: Every single time.

Stephanie Fleming: Without fail.

Steven Bray: And Lindsey you realize that there's a transcript.

Elliot Spoon: Okay let's thank the panel for that, it was very informative.

Panel 4: Strategies with Emerging Growth Companies

John Dalfonsi: I am going to stand, I want to thank Professor Spoon for having me, I also want to thank Mike Raymond with Dickinson Wright for inviting me and Brad Wyatt who's also from Dickinson Wright is in here. We do a lot of deals with them and it was very nice of you to invite me. I live on the West Coast, but I am from the Detroit area, so I knew the true elephant in the room is the game tomorrow. Know that I went to Northwestern so I am kind of a neutral party so you all can be nice to me. I work for a firm called Roth Capital Partners. Just to tell you what Roth does, I joined the firm twenty years ago. And I've pretty much seen a lot. I saw the IPO market. The very strong IPO market in the 1990s, the dot com boom and bust, the resurgence of the market in 2003, the break of the market in 2008, which I am sure you all remember, and now, the resurgence of the IPO. Roth works, I'd say we do about 100 equity deals per year with public companies. Really 95% of our business is working with emerging growth public companies. That's the perspective I bring to this group. I know there are a lot of attorneys here, SEC, FINRA people, but I, and the people in my firm, we talk to these companies, these emerging growth companies every day, day in and day out. I want to give you their perspective as it relates to public markets. Because I think there's tremendous misconceptions of what it's like to be a public company. There's a tremendous lack of IPO awareness. And that's going

to kind of bring me into the story I'm going to tell. We're going to give a chronology of what's happened and where we are today. So going to the first slide, the I.P.O. market disappeared in 2000 and so if you think about it, it went into a fourteen year hibernation. So if you think about what happened, I joined Roth in 1995, in 1996 I worked on twenty IPO's, and from 1993 to 2000 the average number of I.P.O.'s per year, and I have a chart on the next page was 498. From 2002 to 2013, those numbers were cut by a third, to 147. The small cap ranks were even further decimated and I'd say you see a third of a drop of all activity in I.P.O.S but from 2000 to 2014 most of those IPO's were bigger companies. Very little companies and when I mean little companies, companies with market capitalizations of less than five hundred million, someone who might have a 50, 100, 150, million in revenue. Those drop significantly, over 80%. And on the next page, I'll tell this story. What really happened? Why did the I.P.O. market disappear? Three things happened in my opinion. First of all, as we know, the dot com bubble busted in 2000 and no one wanted anything to do with IPO's. The IPO market got way out a hand. Companies were going public at absurd valuations and it was bound to pop. The second thing that happened was Enron. Eliot Spitzer, all the publicity of, one company, the damage and the fall of Arthur Andersen. Just all the damage caused by just one company. Although 98% of companies are very honest and don't cheat a bit, but just Enron alone, what it did for the fear of a company going public or fear to be on a board of directors, had a dramatic effect. During the nineties, the primary method of capital formation for and emerging growth company was the IPO. That was kind of the brass ring. And when the dot com bust and Elliot Spitzer and Enron came in, that was the last thing you wanted to touch. But the third and I think lesser-known thing that happened was something called decimalization. Investment banks have two profit centers. The first is corporate finance, you get a fee for raising capital or you do mergers and acquisitions, but the second was trading. Trading used to be a very profitable business. Say for example we owned an investment bank. We buy stocks traded in fractions, so we buy at ten and a quarter and sell it at ten and a half, so we'd make twenty five cents per share of trade. That went to pennies. So you went from making a quarter per trade, to I'm buying it at ten dollars and fourteen cents and selling it ten dollars and sixteen cents. So if you think about 90% decrease in revenue and profit margins, the firms that heavily invested in trading systems, like a Montgomery securities, they had no choice but to get bought or kind of just went out of business. What happened to investment banking is that investment banking got decimated. What happened was, the firms that had big trading platforms

had to move on, they got acquired, the bulge bracket firms, the Goldmans, the Morgan Stanley's, a big part of investment banking and profitability was gone, as well as the IPO market leaving, they became almost banks. Between merchant banking, private equity, all the other businesses, if you think of Goldman Sachs even it's run by a traitor. And then the middle market firms, more of like a Piper Jaffrey or Callen, they were forced to move to more mergers and acquisitions. So you had very few firms that focused on public equity markets for emerging growth companies. I can tell you, if I sat here and gave myself an over/under of 20 firms that we competed with in the nineties, that aren't there today, I think I would go over that. So if you see the landscape, what it looked like in 2000, you can see that investment banks, a lot less investment bankers, fear of the public markets and hangover that where everyone lost money and this is what has happened over the last 14 years. So what would you think would happen? This has caused the problem today in my opinion of quality small and micro-cap opportunities lacking today and I'll talk a little about why that's important. In 1997, there were over 10,000 major exchange companies. Now when I say major exchange companies, I mean, Nasdaq, NYSE, there was over 10,000 major companies. Now I showed you the I.P.O. chart and how the I.P.O. market completely disappeared. That's the input into the public market. So if you think about what happens when you take out an input, the numbers drop. And if you exclude banks, there's 1,000 public company banks, there's less than 4500 public companies today, If you think about what happens over 14 years, good companies get bought, bad companies go out of business, also a good company goes from maybe a two to three hundred million market capitalization to two or three billion. If you think about what all of that adds up to, there are very, very few investment opportunities in the small and micro-cap space and there's more money than ever in the public market, so you have this complete disconnect. So therefore, the lack of smallcap and microcap public companies combined with record capital has created tremendous demand for these IPOs and I think its relevant for everyone in this room because this is part of your business too. You either represent companies, or ifyou are from the exchange you review them, FINRA is involved in the process as well. I am going to tell you the issue with the lack of emerging growth public companies. The one thing you didn't hear anyone complaining about, is the IPO market and I said that was the major vehicle, or the most common or the most thought of vehicle for financing, that vehicle disappeared. But companies weren't lacking money. What happened was private equity and venture firms moved in. I guess going off the slides and talking about a philosophy I have from a social and economic

perspective. The way I look at private equity and venture firms, and we have great relationships with them. It's a group of entities with very concentrated capital. Where only a few are invited that have been investing in taking up all these emerging growth opportunities of leaders in medical technology, technology, industrial technology. You know companies that revenue growth rates are fifty percent. The growth and hence the wealth, of these companies essentially transferred to those firms, rather than being available to the public market for the broader public through a fiduciary such as a money manager or stockbroker. So you've seen all these successful companies in Silicon Valley, which is one example where all this wealth has been transferred to private equity and venture firms, but the lack of opportunities for the public companies and if you think about when someone goes public, like if Uber goes public, their market cap is going to be 5 or 10 billion, all the money has been made in something like that. It is interesting; I hear that from the money managers. I took a company public in May of last year. It was an oil services company with a breakthrough in drilling technology. And I was with the portfolio manager at Fidelity, and he was refreshed that we brought this company in because he said I haven't seen an idea like this since Home Depot came in six stores. So if you invested in Home Depot, you probably did well. So going to this, today there are over 3,900 private equity firms based in the US. I didn't even count the venture firms; lets say there are 2,100. So there are 6,000 private equity and venture firms in the US and they all have business development offers. They are all calling on these companies. Private equity alone has over five hundred billion in dry powder. Now. If you think about it as an entrepreneur, kind of sitting there, you're thinking about capital. You're thinking about the IPO. You don't even know what the I.P.O. market is because it hasn't been around for 14 years. And you're constantly being inundated with private equity and venture firms. You're saying to yourself, geez, this is my only option. I have to decide between this firm and that firm, who do I want to be on my board or this or that. I talked about the amount of investment, as of last month, there has been over $125 billion invested in venture capital and 500 billion in private equity, that's $625 billion. If you add up all the I.P.O.s and fall-alongs for this year alone and take out currency trusts, but if you add up companies that raised money in public markets you get $62 billion. So there's been 10 times the amount of money invested from private equity and venture. Fidelity alone has more dry powder than all these private equity firms together. You have this incredible disconnect and imbalance. Why? Well I talked about how the private equity firms and the business development officers. Why don't you see IPOS, in my opinion, people don't realize an

IPO is an option. They have no idea how to prepare for an IPO. Since the IPO has been out of consciousness for 14 years, entrepreneurs don't really understand what the IPO process is, it may be a second thought to many of you because you work in this business. One of the companies I worked with, incredible CEO who was a genius in his particular area didn't know what market capitalization was. I had to explain to him three or four times what market capitalization was. He didn't know what the SEC was. He said who is the SEC what do they do. He didn't know what an S1 was. He didn't know the registration process. These companies have no clue, you see these IPO readiness tours, I know Nasdaq does them, I know the accounting firms do them. These entrepreneurs get lost in the first five minutes. It's so basic; the steps you have to explain to them are so basic. The second point is that they have no idea what an IPO is and how to prepare for it. And finally, going back to the investment bankers there's maybe 4 or 5 thousand private equity firms out there. There's not many of us around that were around in the nineties getting the word out that the IPO is an option. The Jobs Act has done an incredible job. I think the jobs act has done a lot of great things, but the number one thing that the jobs act has done to get these companies to even consider an IPO, is the confidential submission.

Before, you used to put your registration statement out three months before an IPO, and then the market goes away. That information is public forever. But the fact that You don't have to go public with your registration statement until twenty one days before the roadshow will start is a tremendous selling point because a company knows that they really don't have to commit to I.P.O. until twenty one days before the road show and at that point as a banker, we can say this is going to happen or this is not. But even though the jobs act is out there, there is still a total lack of awareness. Now why is an IPO an excellent solution? Liquidity for owners. They can sell their stock. One of the points from entrepreneurs, I want to sell my company, why don't I just get money from private equity and I will get bought then? Well, in my opinion the best way to get money is to be a public company. Because you are fully valuing your company and then, if anyone buys you, they'll probably have to pay a premium. And as a public company, I try to explain this to people, the SEC does you a big favor, the fact that you have to disclose all your material information, gives any buyer or any investor comfort that they don't have to worry about anything hidden and I think just the fact that that information is out there drives a further premium for the acquisition of public companies. So it's a great option for liquidity for owners. Secondly, another big selling point is the stock option program.

We talked to a lot of companies in Silicon Valley, they are competing for employees, and the fact that you can give someone options of a public company is a differentiator. The other thing about the public markets, just to tell you a little more about Roth, we only sell to institutions, we don't sell retail. Our customers are Fidelity ,Wellington T. Rowe Price, Invesco, all the way down to the institutional money measure that manages one hundred million. And our road shows our New York, Boston, mid Atlantic, Texas, Chicago, West Coast, Denver, we go throughout the United States and we sell to about 1,000 institutional money managers. As a public company, if you perform, lets say you go public at a 10 P.E. if you perform, your multiples going to expand, because the perceived risk of the company, because you've proven you can actually hit your numbers goes down, instead of a P.E. of 10 they'll pay a P.E. of 12. It's one of the few ways where your valuation can increase based on performance. You'll be recognized and you won't have to push anyone to show that. As I talked before, the deepest public capital in the world. Quick access to the following capital, as you know once you go through the SEC and you are a public company, you file a shelf registration statement. And once the shelf registration is effective, and you've got your FINRA clearance, you can do a deal overnight. Because essentially you could raise money and it almost turns into a trade. Investors are aware of your company. So instead of going back for another round with the venture community, we've done deals overnight and typical fall-along is only a week off the shelf registration statement. Stock abuses acquisition currency and then the other point that I think is very interesting is that when we take companies public. And its very refreshing to see this, management owns 100%. We typically sell 20 to 30% of the company in an IPO. So management still owns 70%. And investors love that. If you go through the ownership tables in private companies you won't find management owning more than a ten percent stake, that's options included as well. I think when you have the bigger and ownership the investor alignment between management and investor in the corresponding corporate governance is so much stronger because if you think about who has more skin in the game than anyone, it's these entrepreneurs. So I think that from the entrepreneur's side. One of the misconceptions that investors have when you go public, I mean a companies have when you go public, is that they're afraid their company's going to get taken over. And you explain to them, well you own the majority still, although you have an independent board of directors. They get to keep majority of their company and they're totally aligned with investors.

Audience Member: Can you talk a little about what the typical characteristics are of a company like when is a good time for them to start considering the IPO option? What that threshold is, where it really does become a viable option for the company.

John Dalfonsi: Yeah, I will go into that in a second, thanks for asking. So here are the misconceptions. The I.P.O. market is only open for big companies. I'll show in a minute why it isn't. Or one thinks well geez it's only open for Facebook or Twitter. Absolutely not. About half of the companies completing an I.P.O., excluding biotechnology, actually have revenue less than one hundred fifty million and regulatory scrutiny. You know actually the Jobs Act I think has made it easier. The SEC is there to help companies. And there is a misconception that. That that might not be the case, because of the memory of Enron, who deserved what they got. But you're an honest company, you've worked hard. Regulators are going to work with you. Institutions are interested in small micro-cap company's. Biggest investors in R.D.O. include fidelity and Wellington and then loss of control. I am just going to show some quick case studies, Talking about the size. This was a biotech company that's about half of the I.P.O. market, we raised fifty million for them. This is a company that actually sold that had a bunch of solar facilities, it sold energy.

So, here are the misconceptions: IPO market is only open for big companies. I'll show in a minute why it isn't. Everyone thinks, 'well geez, it's only open for Facebook or Twitter,' absolutely not. About half the companies completing an IPO excluding biotechnology actually have revenue less than $150 million. Heavy regulatory scrutiny, you know, actually the JOBS ACT, I think, has made it easier. The SEC I think is there to help companies and there's a misconception that that might not be the case because the memory from Enron who deserved what they got, but you're an honest company, you've worked hard, the regulators are going to work with you. Institutions aren't interested in small, micro-cap companies. Biggest investors in our deal include Fidelity and Wellington, then (Lost/Lassig Control). Can you go up to the next slide? So I'm just going to show some quick case studies. Talking about the size. Go ahead Mike. This was a biotech company that's about half of the IPO market we raised $50 million for them, but...why don't you go to the next one...this is a company that actually sold it. They had solar facilities and sold energy their revenue was only $28 million. Go to the next one. Fidelity was the lead investor in that. This was a chain of chiropractor clinics that only had $6 million in revenue and they were valued off 2017 revenue because investors will look forward in terms of your valuation

but they only had $6 million in revenue - it was the team that rolled out Starbucks on the west coast. The next one, this is a medical device company that had about $15 million in sales. We did this at $6.25, it's about $25 now. Again, WASACH which is a major fund out of Utah invested in this. Next one. This is a drilling products company. About $15 million in revenue. Fidelity and Wellington were the leads here. And then finally, this is a company that has raised about $50 million in the public markets - an engineering and consulting solutions company we did this at $6 it's about $25 now. So those are to just give you a sense that it's as long as you have about $10 to $15 million in revenue and are growing, double-digit, an IPO could be an option for you. Anyway, thank you. *Applause*.

Michael Raymond: In case there were any misapprehensions, you can probably pick out the Italian in the group here. I've been on enough speaking circuits with John so that I'm pretty used to the Italian-speak. John and I recently completed about a five-city tour on demystifying IPO's. Basically about what's really involved in the IPO market nowadays because there's a tremendous amount of mystery. So we've been fairly successful, we think, in spreading the gospel that the market is back and that it's certainly going to be vibrant for probably the next couple of years. By the way, I'm losing my voice, I start to sound like Demi Moore about this time of day so I apologize. I can take literally all afternoon to talk about what it takes to execute a Jobs Act IPO so I'm going to talk fast like the disclaimers at the end of a pharmaceutical ad. I'm going to hit some of the high points and do my best to at least sensitize you to some of the intricacies of what it takes to execute an IPO. Lisa is going to give you an inside look in terms of how the SEC processes an IPO registration. Hopefully between those two perspectives you'll get a good sense of what's truly involved. So the way I approach this presentation is to chunk up the process into three pieces. The first piece is the planning stage. This is before you can engage the investment banker. Before you've started to write the S1. Where you're really starting to think 'ok, is it a good time to go public?' Maybe you've seen John speak and you're like 'I'm intrigued' and then you want to talk to him. You talk to other investment bankers. And you decide you've got to go Italian. So anyway, if you do that then it's time to be thinking about what's the process, what's the pre-planning of sorts that we have to engage in? Well, here are some thoughts in that, you know, pre-planning process. First of all, are you an emerging growth company? To conclude that you're going to need to be under a billion dollars in revenue during your last fiscal year. You're going to have to take a look at the

advantages that are available to you as an emerging growth company and decide whether or not you're going to take advantage of them. 85-90% of all IPOs in 2014 were emerging growth company filings. And I would venture a guess that almost all of them took advantage of the scale disclosure benefits and things like that that EGC's are afforded under the Jobs Act. But things you have to evaluate. We have on occasion had clients who have come to us and saindd 'ya know, we know those options are available to us and we don't have to disclose certain things but we kinda want to quack like a big duck.' We kind of want to look and feel like we've made it to prime time so we'll counsel them on the pros and cons. Most often we can talk them out of it and they end up taking advantage of scale disclosures. One of the things that you'll have to consider very early on, as John will indicate, a gating item, is can you produce two years, because you get scale back from regular 3 year requirement, two years of audited financial statements? Notice parenthetically these should be 'unqualified' because the last thing you want to have to do is have an auditor qualification pop up in the midst of your IPO process. So you really have to have your books pretty clean and you have to make sure that you are going to make it through, in an unqualified fashion, in order to produce your IPO registration statement. We no move into the actual quiet period which is when you file confidentially with the SEC. Is there a hand in the back?

Audience Member: Does the audited financial statement have to be a PCAOB auditing firm?

Lisa Kohl: Yes, the auditor has to be registered with the PCAOB.

Michael Raymond: Now, I won't get into too much detail, but there are certain circumstances where, even though you have the ability to just produce two years of audited financial statements, it may behoove you to produce three years of audited financial statements. For example, if you've got sort of an anomaly that would, had you produced the three years, sort of correct that anomaly. That might be a circumstance in which it makes sense to do three years. So, again, part of the planning process…you also have to think about the stub period financial statement – which would be unaudited – but will be reviewed by the SEC auditors. What period has to be included within the registration statement? You have to be mindful of what are called the 'staleness' rules. So, by the time you go effective, you have non-stale financial statements included in your registration statement. Next, selection of your exchange: NASDAQ v. NYSE; basically the same. Some governance distinctions.

You have a minimum public float requirement, and shareholder body count requirement, 300 roundlot v 400 shareholders. But, generally they're virtually the same. You'll find as you're entertaining an exchange listing that both exchanges will be very aggressive in trying to pursue you to get you to come into their exchange. We could get into some of the idiosyncrasies. If you have some private placements that are ongoing and shutting those down. If you've got, as a closely held company employee stock grants underway what you should do vis-à-vis certain rules that might come into play as you get into the registration statement process? One of the very common SEC comments relates to what is called 'cheap stock' - which relates to discounting of the stock prior to the IPO. So if you have these in place, they can create some extra SEC commentary, John will tell you, if you've had a relatively contemporaneous equity transaction or option, has a price reference, right? That inferential price can have an implication in terms of pricing out your IPO. Because it's going to be all publicly available information. So you've got to be mindful of what the marketing and the IPO pricing implications are for these sorts of things in place prior to the IPO. A few additional mop-up planning items: Related party transactions. This is sort of a Mecca of commentary with the SEC and you really need to visit it early on. An example – the principal stock holders leasing buildings to the company. Are they at fair market value or above fair market value? And things like that. So, you have to get in early and you have to ask yourself how is this going to play out in terms of SEC disclosures which are fairly rigorous. Think about maybe re-pricing those or reengineering those particular transactions. Quite commonly if you've got companies that have sort of matriculated up through the food chain in terms of capital raising, you'll have seed, venture capital, maybe mature venture capital, angel, documentation that's in place. Not uncommon to have registration rights and other investor protections. You've got to navigate your way through all of that and determine, okay, if we execute an IPO what do we have to do? Do we have to undo any of that? What's the underwriter going to think about somebody having a demand registration right post IPO? Or a piggy-back registration right? Those are all the kind of things that have to be sorted out in this planning process. Some of the other things in terms of executing the IPO. There's a thing called an overallotment option. This is where if the IPO is over-subscribed, which means there's much excitement about getting into them that they fill up the, what we call the primary portion of the IPO and there's a 15% option that's granted to the underwriters called either an overallotment or a green-shot option. That is there basically for them to kind of fill that out. It's also…the underwriter can basically exercise that and use that

stock for market stabilization after the IPO. So, again you have to think about, 'ok, who is going to sell into the overallotment option?' Is it just the company that issued the primary shares or is it going to be selling shareholders? Or some combination of those? Again, part of the distinction in terms of who is the seller into the IPO. There will always be a lockup period with an IPO. This period is a contractual obligation with certain key shareholders where they basically cannot dump their stock into the market post-IPO for a period of time. The reason for that of course is if you have insiders who are dumping their stock its going to send a chilling message to the market and the open market price. So very common to see at least a six month lock-up as part of your underwriting arrangement. So that's all kind of before you decide to turn the switch on. So now we're into what's called the 'quiet period.' Traditionally, I'd say most practitioners say this begins when you engage your investment banking firm. From that point forward, you start getting into certain SEC rules that are going to govern your behavior. Basically your corporate communications policies will need to be visited to make sure they're curtailed based upon those rules. So during the quiet period you're going to determine how often are we going to get in and out of the SEC? How many turns on that registration statement should we contemplate before we get to the public filing, ok? I'll be interested in Lisa's view on this, but generally, if we've had a lot of advance work on a registration statement and feel really good about our due diligence and it's all completed and we've got good disclosures and good financials, and the company is relatively squeaky clean we contemplate two terms of comments with the SEC during confidential submission. And then we're ready to do our live filing with the SEC which is where you become publicly visible as a filer. I don't know what your experience has been.

Lisa Kohl: We typically see anywhere from one to three amendments processed through the confidential submission process so that would be your draft registration statement and one confidential amendment anywhere up to three.

Michael Raymond: So you're going to be laying all of this out and kind of mapping everything out. Effectively where it works as a practitioner is you're going to talk to the underwriters and say 'when do we want to hit the market?' 'When do we want to commence the road show?' And then you're kind of backing up from there anticipating turns on your registration statement and a 21 day waiting period before you can commence that road show. A ten day to two week road show period. Four or five days after that a pricing meeting. And then go effective and

close. I'll touch on all of that, but that's kind of the thought process in how you layout your chronology of events for your IPO timetable. We talked about how many turns of the S1 before you go to a live filing. By a live filing what I'm referring to is the non-confidential filing. This is important because in the old days you didn't have this confidential submission process available so you couldn't kind of pre-vet your commentary with the SEC and this was all a matter of public record as those comment letters or comment process took place. Now you can sort of get up to the precipice and then decide ok we feel good, the market feels good, and we're going to go forward and file our live S1 filing. It's all been pre-vetted and hopefully at that point all you're doing is waiting for that 21 day down period to expire and then you commence your road show and then from there it's automatic. That's where the underwriter is basically going to sell the public offering and things should be on autopilot at that point. The live filing is relevant because that's the point in time when the officers and directors and issuer take on section 11 strict liability. The officers and directors have control person liability basically that's when the real exposure is kind of elevated and that's when you've got folks that are signing registration statements and the professionals' malpractice policies become relevant. So, it's a big deal to become a matter of public domain. Part of the 'onramp' provisions that came through the JOBS ACT as there are testing the waters capabilities with certain types of investors. These are all qualified institutional buyers or institutional accredited investors and those are the only type of people you can be testing the waters with. But you can really kind of get out there and put your toe in the water and determine whether or not this kind of IPO is going to price well or fetch the market caps that the underwriters are anticipating. So it's a good device if you plan to get out there and see what your company is going to fetch. There are some other corporate things you can be doing during this period of time. You can be adjusting by way of stock-split adjustment your capital structure in. You might have to consider anti-takeover provisions. Some public companies keep them in place for control retention. Some adopt 'anti-anti-takeover' provisions. In other words, they want to make themselves attractive from a takeover perspective. Other things, you've decided on an exchange and you've got to get your board of directors together and have a majority of outside directors, independent directors to satisfy the criteria of the pertinent exchange. You're going to have certain committees: the audit committee, the compensation committee in particular. The chair of the audit committee for example has to have super-independence and financial expertise. All of these things are kind of falling into place at this point and those folks are going to marquee'd in the S1 as part of the

board of directors. Check your website during this period of time. Do you have anything that's sort of incongruent with the S1 disclosures? If you have some language on your website that sort of suggests that you're going to be offering through the website and sort of condition the market through your website, you have to take a hard look at the contents of that website and I'm sure Lisa will comment.

Lisa Kohl: We're going to look at your website.

Michael Raymond: So that's something that's quite common and probably one of the very first things you're going to take a look at. Underwriters due diligence is going to be taking place. Officers and directors are going to be interested in D&O insurance with the securities rider. And they have to secure a transfer agent, financial primer, and bank note company. Now you file the registration statement – what kind of comments can you expect to get and what are some of the common SEC pitfalls as you get through that review process. Just read them, I'm not going to go through these. I think Lisa can probably touch on a few of these in greater detail, but these are the common items that come up in the SEC comment process. Knowing that these are likely coming up, you should read them off at the pass before you file. You don't and wait and see if the SEC is going to find them, right? These are the things that anyone representing an issuer or underwriters has to be sensitive to. So we talked about with the EGC filing how there's a 21-day down period before the roadshow can commence. John will tell you that the underwriter, just prior to the roadshow, is going to bring in management. He's going to get them prepped for the roadshow. He's going to do a 'teach-in' which is basically where they get all the sales team, the analysts, everybody is kind of amped up about this roadshow which is about to commence. You're out. You're doing the roadshow. Life is good. Feedback is coming in. All the institutionals are giving indication of interest at this point. You're out there with your red herring prospectus, which doesn't have final price information, but it's got range information and, the investors are liking what they're seeing and hearing in the roadshow so it ultimately manifests in underwriters and management coming back from the roadshow saying 'we're good.' Lawyers, are we good on the SEC comment side? We're good. Auditors, are we good? Yes. Then we tender the acceleration request to the SEC. And that's where we are requesting the SEC to basically issue an order declaring that our registration statement is to go effective under the '33 Act. The SEC's policy in terms of how far in advance your requested effectiveness date varies, we see it between 24 and 48 hours.

Lisa Kohl: The rule, which I think is 471, it might be 473, says forty-eight hours but we'll often work with you if you know you can't quite meet that time frame and the assistant director groups have discretion to shorten the window in their role.

Michael Raymond: So, in addition to the acceleration request with the S.E.C., underwriter's counsel will have secured what's called the no objections letter. This is where FINRA will basically determine a number of things, but first and foremost that the compensation that the underwriters are getting in the I.P.O. is fair under the pertinent rules. And then finally you'll be working with the exchange and get their clearance. All systems are go. So the day after you're basically effective, your aftermarket starts right so you're going to begin trading. Now, under the settlement rules, you have to basically close out the I.P.O. transaction within a certain period of time and that's when your closing on the I.P.O. takes place. Generally, we map out four to five days after the I.P.O. for that take place. You've got the champagne on ice and everybody's feeling good. It priced out right; and then it's just a matter of settling. The market has started to trade. You'll have to file a 424(b) prospectus with the S.E.C., which is the final priced out prospectus; issue a press release with a lot of fanfare; and then you basically settle up under the underwriting agreement with the underwriter; and then register the securities under the 34 act, that's your form 8-A. Oftentimes there will be an employee stock option plan that has to be registered as well. That's taking place. And finally we talked about the green shoe, the overallotment. Sometimes that's exercised concurrent with the closing and sometimes it's exercised within a forty-five day period after the closing. So, I think that is it. Lisa, all yours.

Lisa Kohl: Alright, thanks. I don't have any slides, apologies for that, but I didn't have my act together in time to get that through our ethics office. As you can imagine we are fairly careful about what we publish in writing, largely due to concerns over shadow rule making, which isn't as scary as shadow banking in terms of the name but, you know, that that's kind of why I don't have any slides for you. Thanks, you know, I want to echo the thanks. I'm glad to be here today. I do have to tell everyone that in the interest of full disclosure, my loyalties lie with school down the road so…you know that was supposed to be a disclosure joke. And so I have been talking to a couple of people before this started, and so what I wasn't planning on doing though I'm going to do is just provide a little bit of background on what we do in corporation

finance because I am hearing that when people think of the S.E.C. they think mostly of the Division of Enforcement. But the division of corporation finance has, you know, over five hundred people. We largely review public company filings and that is registration statements, which almost all—other than certain registration statements which go effectively automatically by operation of law—almost all other the registration statements, so I.P.O.s and the shelf registration statements that John was talking about earlier, do need to be declared effective and are subject to review by the S.E.C. So, we review all registration statements that are filed and then also, you know following the Sarbanes-Oxley Act of 2002, we are statutorily required to review all public company Form 10K's or 20F's, depending on whether the issuer is foreign, at least once every three years. So that's largely what we do in corporation finance.

I am a legal branch chief in the division of corporation finance which means that I oversee the legal team and serve as a senior reviewer in one of the disclosure operations groups. And I'll explain the reference to disclosure operations in a minute. But I am the legal brains chief in the office of consumer products, which is not really an accurate name but we haven't gotten together to change it yet. The registrants in my group are retailers, which includes you know your Target, your Best Buy, you know grocers...We also have public utilities: water, gas, electric, and then also you know entities operating in the, you know, master limited partnership transportation of natural gas space. And I bet every day's been waiting for this, but before I really get started I need to give the standard disclaimer that the views that I express today are my own and do not necessarily indicate the views of the commission, the commissioners, or any of its staff. And so, what I want to do is to round out John and Mike's presentations by providing you some insight into the filing review process in corporate finance. You know I think, to use a baseball metaphor because again football's probably a little touchy of subject this week you know, John and Mike talked to you about…you know, let's say John to talked you about the decision to play the game and Mike's gotten you around the first couple bases. I'm going to talk to you about the, you know, the path to effectiveness, which I'm going to call home plate. I'm going to cover kind of two main topics. The first being the filing review process generally; and then second, the sort of best practices, what sort of things should you be thinking about…you know how can this go as smoothly as possible for you and quite frankly for us.

We've talked a lot about emerging growth companies and I just want to clarify that I'm not really going to differentiate very much in the filing review process because it's just other have the ability to submit the filing confidentially the process otherwise just isn't very different, you know. Initially after the JOBS Act was passed, there was a slightly different procedure. We were doing it in paper at first, but you know we've got things in place where we're allowing people to file draft registration statements on EDGAR just as you would if you weren't filing confidentially. And so the process is otherwise going to be, you know, the same for a JOBS act and a non-JOBS act file. So we stick with the baseball kind of metaphor, the first thing that's going to happen when you file a registration statement is it's going to be assigned to an AD group. And you know, I was surprised to learn that people think that the assignments are kind of made randomly—that's not true. We are organized into eleven operations groups on the disclosure operations side and were split into, you know, different industry or sets of industry sectors because you know the universe of public companies doesn't nicely fit into a eleven separate industries. We do that largely so that there is some expertise on particular industries. You know that's important on both the legal and accounting sides, you know. For instance in my group we have utilities and you know regulatory accounting for utilities is specific and, you know, the accountants in our group have, you know, a fair amount of expertise in that space.

And so once the filing has been assigned out to a particular group, we will "screen" the registration statement. You know we don't publicize our screening criteria, but what I can tell you is that, you know, kind of as a product practical matter, every registration statement that's an I.P.O. is going to get a full review. And what that means is there will be four people reviewing each filing—there will be a team of lawyers and a team of accountants—we kind of call them examiners and reviewers. The examiners will take, you know, the first crack at the filing. What they'll do is, and Mike touched on this, you know, we'll not only review the four corners of the registration statement, but we'll also get on your website, we'll look at the news, and we'll try and look at you know any information that's publicly available. And that's largely to, you know, contextualize things for us and, you know, we're necessarily reacting to, you know, a limited universe of information and we're just trying to expand that information to the extent we can.

So, the legal and accounting examiners will take kind of the first crack at the filing. They'll review, you know, everything in the public domain;

they'll send an examining report to the reviewers. And, you know what, I don't think people sometimes often appreciate is there's a fair amount of back and forth between both the legal reviewer and examiner, the accounting reviewer and examiner, and then among the legal and accounting disciplines to come up with, you know, the comments that we've decided to issue and the issues that we think are material; and there's a great amount of discussion that happens before we actually, you know, issue a comment letter to anyone.

In the I.P.O. context, the examiner will contact counsel, and by this I mean counsel for the registrar underwriter's counsel and this is usually the person listed in the center of the registration statement or on the left side is where registrars counsel tends to be named. And what we'll do is first provide you with contact information, you know, for us. You'll probably only get the contact information for the examiner at the outset, but everyone on the review team's contact information will be provided at the end of the letter. And we'll also at that time ask company counsel to send as contact information for both counsel and the company. We got with the program a couple years ago and decided to start sending our comment letters via e-mail instead of mail or fax. And we'll mail the comment letter to…you know generally we limit it to two persons and that's typically someone at the company, which tends to be either the C.E.O., C.F.O., or general counsel, and then usually the…it tends to be whoever the lead partner is on the registrant side, registrant's counsel's side. Comments I think…you can expect typically to receive comments between twenty-seven and thirty days after the registration statement is filed. And that is the same whether it's filed in draft form or whether it's filed in, you know, on an S1 that's, you know, publicly available from the outset. We'll send out the comment letter; the company will respond. And then you know, ninety nine times out of ten they'll file an amended registration statement and, you know, that'll kind of start the process all over again from our point. We'll all go back and forth, you know, until all material issues are reviewed and, you know, all outstanding comments have been resolved. And that's kind of like the quick take on, you know, what the process is, and I want to go over just a couple things that I consider best practices and then, you know, I think are good tips for working with the staff.

The first and perhaps most important thing from my perspective is to communicate with us, you know, early and often about a, you know, an anticipated deal time frame. We understand that there are market windows that people are trying to hit you know the markets obviously

been, you know, volatile as of late and we'll do whatever we can to work with you on that. But as I'm sure you can all appreciate, we are often processing many filings at once and so to the extent we have a heads up from you all as to, you know, simple things such as we expect to file around just you know our amendment on Tuesday, or we expect to provide pricing information to you on Wednesday. That also is true for, you know, any material or big picture changes to the registration statement that, you know, would be unexpected to us. You know there are…We've had times where a C.E.O. has, you know, kind of resigned in the middle of a deal and, you know, there's going to be a lot of disclosure about why and you know it's always good you know to have a heads up and talk with counsel through the changes we would expect to see in a registration statement, you know given whatever the triggering event is.

And then also just helpful to be as detailed as possible in the response letter. We sometimes get responses that just says 'We have complied with your comment' that don't, you know, provide any additional detail and, you know, that necessarily slows us down a little bit because we then have to, you know, try and figure out what you mean by your response. It's helpful if we can get a little bit more information like 'We complied by doing X. and it's on Y page number.' That will help facilitate the review from our perspective. And then, you know, inevitably there will be times when, you know, you disagree with a particular comment that was issued and…you know that's bound to happen and we're happy to talk about it. You know as I referenced earlier, we necessarily are reacting to, you know, less information than you have about the business and the industry and the company. So we're happy to talk about it. What I do want to let you know is we're unlikely…sometimes we'll get calls and people ask us to, you know, not issue that comment sort of retroactively. You know we're happy to talk to you about it. What we're most likely going to say is okay. Can you put that response in writing and, you know, we'll consider it in reviewing the amendment and looking at the comment letter. Then, you know kind of to that end, there also sure to be instances in which you know you are frustrated by the answer you've received or you have gone a couple rounds on a particular issue with the review team and you just you know you kind of at a pass. You continue to disagree and you want to take the issue up the chain. That's fine. That's good. You know, I can tell you personally I'm happy to facilitate that. If we're chatting and you know we've come to an impasse that just you know neither one of us is happy with, you know, I'm happy to take that up the chain to my boss and, you know, there is…the one thing we do ask you to do is to kind of follow

the chain of command and our organizational chart is on our website. And our contact information is all on our website. It's just more efficient that way. There have been times, you know, people think the best thing to do is just call the division director, you know. You could call Mr. Higgins, but he's just not going to know what the issue is and the first thing he's going to do is send it back down and, you know, ask people to figure out what's going on. So you know, reach out to us or reach out to whoever is first in the lot of command and were happy to talk with you about issues you know we're trying to get to the right answer. So, you know we're happy to do you know have any dialogue that you all think is necessary.

I have all sorts of other things I could say but let me see what I want to end with. You know I think the last thing that I would say is...that happens a lot is you have someone on the review teams contact information because we have emailed you a comment letter. That's not an invitation to communicate with us via email about anything. I mean you can e-mail us. Just know that we are not likely to respond if it's about a substantive matter, because this goes back to the point I made earlier where were understandably cautious about what we communicate via email especially because that can be, you know, forwarded in the matter of minutes and all the sudden, you know, one examiner has allowed somebody to do something and now it's you know an industry practice that we have to try and walk back. So you know be careful what you e-mail us. I'll e-mail with people about setting up calls and logistical matters, but you know we're not likely to have a substantive dialogue with you via e-mail. And then the last point on that is also be careful what you send us in an e-mail. People will occasionally send Rule 418 materials which are supplemental materials that, you know, the sender requests that we either destroy or return at the end of our view. If you've sent them to us via e-mail, we're not going to be able to do that because once we have received it electronically, we have a record of it in perpetuity and, you know, we're going to have that information forever. So you know, be careful about that, and we're well past our time now.

Elliot Spoon: Any questions for the panel?

Audience Member: Earlier you were talking about all U.S. exchanges. Did you ever run into anything relating to using the Toronto exchange? Or is there a comparison? Is it more difficult in the U.S. than it is in Canada to do one of these filings and have they done anything to try to attract business over there, and as like a comment from you for the

students here, would it be advantageous for them to take some international taxation when it comes to this and pricing it out for either a Toronto exchange or a New York Stock Exchange?

Michael Raymond: Well. John can speak to you know whether or not going on the Toronto Exchange enhances or detracts from the underwriting experience you are going to have on an I.P.O. But, we have on occasion represented clients that…and usually it's either industry specific or it's there's some other reasons that they want to go on, you know, I'll call it a foreign exchange, but just we'll use the Toronto exchange or maybe the lower tier of the Toronto exchange which is the TSX. OK. And you know, usually those reasons are sort of idiosyncratic to the client. I really can't tell you that TSX or the, you know, the Toronto exchanges more robust or viewed as more liquid. I'd say it is probably not the case that NASDAQ and NYSE are generally viewed as a much more efficient price formation exchange than the TSX. You can maybe carve out from that statement, you know, oil and gas companies which generally tend to, you know, cluster around the TSX and in the Toronto exchange. But, you know, Yes we've done some foreign filings through our Toronto office actually. On I.P.O.s, is the process the same? Roughly, but the rules there are fairly dramatic rules. We also have on occasion dealt with situations where they want to dual list, which presents some unique issues as well. They'll list on the Toronto exchanges well as in the US, and that has its own set of, you know, challenges. But, so it's sort of a mixed bag of experience but high level. We're not seeing a lot of companies that want to go public that are really qualified to go public and are saying, you know, I want to go on the Toronto or even the London exchange or even the AIM market. They're generally looking more at the qualifying reason for that is mostly because those exchanges have kind of created a lower tier to capture more business. And, you know…they've got sort of reduced listing standards for some earlier stage companies nowadays that, you know, they didn't have before.

John Dafonsi: Isn't it really that…do NASDAQ or NYSE deals that those are the deepest market. Those have the most liquidity. Everything else is a subset. As a relates to what a law student…In my opinion, the best thing is a relates to this panel a law student can do is any sort of class that allows you take a large amount of information on a company and take out all the material information. Be able to write it clearly, concisely in a registration statement because that will just make your

process with the S.E.C. go better. And that that's the number one skill. So a good attorney is going to say here are the key material items, quickly disclosed on a registration statement in a way that's very understandable. That that's what a good attorney does. And that's good if you learn it at law school.

Elliot Spoon: Well they certainly learn that in my class.

John Dalfonsi: So there you go…Professor Spoon's class.

Elliot Spoon: Well let's thank the panel.

Panel 5: Securities Litigation Development

Elliot Spoon: We're going to get started if you wouldn't mind taking your seats please. Thank you so much. For the law students while you're getting settled. I wanted to mention and you may have gotten some notice of this—there's a writing competition that's associated with the seminar for law students only. It's a competition that you can write for on securities litigation or securities laws. You can write a specific paper for it or you can use one you've used or written for a class or for the Law Review. There are pamphlets outside regarding the criteria and so forth. The winner will receive $1500.00 and be presented at the next seminar next Fall. The deadline for submission is June 17, 2016 and there are flyers out there if anybody's interested.

So our next panel has to do with securities litigation and actually we're very pleased to have three very well respected litigators on our panel. This is Securities Litigation Developments. The first panelist is Mark Kowalsky from the Jaffe firm. Next to him is Clarence from Miller-Canfield. And next to him is Mark Pozza from the Miller Law Firm. On a traditional basis, the first two gentlemen traditionally represent companies or defendants and Mark's firm is one of the preeminent plaintiff's lawyers. In, really in Michigan certainly, but in the country with respect to that so he'll be providing a more balanced and unique aspect to the securities litigation issues. So Mark, why don't you take it over?

Mark Kowalsky: Thank you. First of all, thank you to Ray and Elliot for all your work in putting together today's presentation and to everyone who has stayed to the end of the program. As a member of the panel we certainly appreciate that. We will, as part of our presentation over the next forty-five minutes talk about two primary subjects. One is the recent Supreme Court decision in the *Omnicare* case then also focus a little bit on the recent developments in Ponzi schemes. With respect to *Omnicare*, I'm going to walk you through a little bit of the history of this case through the Sixth Circuit and the District Court and to the Supreme Court including the recent ruling in March and then I'm going to pass the baton to Mark who is going to talk about developments since the decision in March. And Mark has some very unique comments and perspective on real-world implications of these types of claims and some of the personal experience he has had in prosecuting the claim.

I know we have a number of law students here today, and as I walk you through *Omnicare* really, at its heart, at its essence comes back to some very basic principles that you learn early on in law school and that is—what are the elements of a fraud claim, and of a direct representation, and what happens in the case of an omission. And as you listen to my presentation and you think about what you've learned about those words, I think it's going to help you understand a little bit as to what the court did.

Let's talk about the *Omnicare* issue. *Omnicare* is a name we've heard about over the years, there have been three major decisions from the Sixth Circuit regarding different standards of federal securities laws claims. And *Omnicare* 1, back in October of 2009, the Sixth Circuit discussed the elements of loss causation. Then *Omnicare* 2, as it's called, in May of 2013, the Sixth Circuit discussed liability under Section 11 for a company's opinion, which is contained in a registration statement. And then most recently *Omnicare* 3, back in October of 2014, discussing the pleading requirements for 10(b) claims.

What we're going to focus on this afternoon during our presentation is the most recent decision in *Omnicare* 2 which went up to the Supreme

Court and in that decision in March, the Court discussed at length and set some new standards as to what do you look at and what liability exists for opinions in registration statements. And opinions versus clear factual statements. Let's just spend a few seconds on the background.

Omnicare involved the 2005 stock offering. In the registration material, *Omnicare* contained what it said was an opinion regarding whether or not its practice of accepting rebates from drug manufacturers was a legal practice. There was litigation after the offering. First, the federal government sued the company for a violation of the anti-kickback laws relating to those rebates. And shortly thereafter shareholder actions were filed, claiming that the opinions that were contained in the registration statement were false and misleading, resulting in Section 11 liability. A very quick primer on what are the possible causes of action. As we all know, the Securities Act of 1933 requires the filing of a registration statement that has to contain certain detailed information. And that information can come in the form of either fact or opinion. Section 11 of the Act provides that there is strict liability if there is an untrue statement of material fact in the registration statement or strict liability if there is an omission to state a material fact that is required to make the statements not misleading. Again, those few sentences should ring a bell, again, for law students and other practitioners.

Now, remember as we go ahead in this discussion over the next few minutes, that Section 11 is strict liability and, unlike Section 10(b) of the '34 Act, does not require that there be scienter. After the claim was filed under Section 11, the district court in Kentucky granted a motion to dismiss finding and applying the *actual knowledge* standard. And it said that unless it could be shown that Omnicare knew and had *actual knowledge* when it stated its opinion, the claim fails. And so the district court dismissed the claim finding that there was no evidence that Omnicare knew when it made the statement of an opinion, that it knew it was false. The Sixth Circuit said, "Wait a second, we disagree with you district court" and they noted that Section 11 was a strict liability statute, and adopted a very interesting test. A test that carried through the idea that it's strict liability—if an opinion is stated, but it turns out that

opinion is wrong, there is liability. So, if there is an opinion, for example, that the practice was a legal practice, ultimately, regardless of whether there was good faith and proper due diligence in stating that opinion, if it turns out that, that opinion was false under the Sixth Circuit view there would be liability.

The case went up to the United States Supreme Court. The Supreme Court decision in March set a different standard. The Supreme Court briefing drew a lot of attention and both the Solicitor General and the SEC took their own unique positions, which were different than the district court and different from the Sixth Circuit's view. In the decision, the Supreme Court as you will see rejected both the district court's *actual knowledge* standard and rejected the Sixth Circuit's *objectively false* standard and created a different standard. And the standard the Court set out in March really contains two separate paths toward liability. The whole Section 11 analysis never contained those different paths. There was one path for a misstatement of fact, and then there was a second path towards liability that related to opinions.

The first path is relatively simple. That is that if a registration statement contains a misrepresentation of fact, um there is liability. But there would be no liability if the opinion, if it's not a statement of fact, but its an opinion that just turns out to be wrong. So that's easy, and that's something that we've always thought about in those terms. Now, the second path that was created related to opinions, and the Supreme Court said there will be an actionable claim if the opinion was stated without the person, the company, doing it's own due diligence and stating the related facts to make sure that opinion was not misleading. So let's talk about the muddle that's created by the second opinion prong of liability. As I said, the first path is relatively easy, uh, but with respect to the second path, what the Court said, and I have the quote here, "that investors do not and are right not to expect opinions contained in those statements to reflect faceless, off-the-cuff judgments of the kind that an individual might communicate in daily life." So, here we have this strict liability statute, which courts traditionally have found to have no consideration of intent. If you think about it, what that language does, it

almost brings in some sort of intent component to strict liability because you have to look at the intent and whether or not there was recklessness in stating the opinion. Uh, what the Court said in adopting this new standard—phrases like "we believe" or "we think" can preface nearly any conclusion. And a safe harbor for all statements phrased as opinions would punch a hole in the statute for half truth in the form of opinion statements. So therefore, a statement "we believe that our financials comply with generally accepted accounting principles," they say "we believe," but of course, as the Court recognizes here by adding those words doesn't create a safe harbor.

The Court gave a few examples that companies may find a little bit troubling. It said that if an issuer makes a statement, "we believe" our conduct is lawful without having consulted a lawyer, the statement could be misleadingly incomplete. The Court then balanced that by saying that meeting that standard would be no small task for an investor plaintiff. To be specific, an investor must identify a particular, material fact going to the basis of the issuer's opinion. Facts about the inquiry, the issuer did or did not conduct or the knowledge it did or did not have, whose omission makes the opinion statement at issue misleading to a reasonable person regarding the statement read fairly and in context. Let's think about some real world examples on that. Think about in terms of a statement that's in a registration statement the company says there's a substantial growth prospect for the company. By saying that we believe there to be a substantial growth prospect is insufficient to create a safe harbor, to avoid any liability. It's quite possible if there is a challenge, the court is going to look at the language and determine whether or not background was given as to what the basis was making that, stating that opinion. They will look at whether the company conducted a market study. Was it an in-house market study? Did they get outside independent study of the market? Did they properly analyze competition? And did they properly balance all of those factors in stating their opinion?

There was a statement actually in the concurrence that I think is significant. You have my written material, which talks about the plaintiff's views and the defendant's views, but to summarize—The

commentators look to what Judge Scalia said in his concurrence. And trying to bring down into a simple sentence what a practitioner might take away from the decision and that was his comment that a reasonable investor is right to expect a reasonable basis for all opinions in registration statements, unless that is sufficiently disclaimed. The result is that we have little predictability. There is tremendous factual inquiry, and no clear guidelines as to what you have to put in the registration statement to give you some comfort with respect to opinions.
One final point before I turn this over to Mark, is that remember as you do this analysis, that this relates to Section 11, and does not impact Section 10(b). And I say that, but Mark will tell you that some of the courts subsequently either intentionally or otherwise are now allowing the Section 11 standard to creep into Section 10.

Mark Newman: I'm going to sit here, if that's alright. Just to give you some quick background. I've been a Securities Class Action litigator, uh for at least since graduating law school for the last roughly twenty years. And recently, I was the primary attorney at my firm, co-lead counsel in a major securities fraud class action against AIG. Um, that uh really involved events that led up to AIG's $180 billion dollar bail-out from the federal government.

That case settled in March of this year for $970 million dollars. And this issue was really the primary issue that was litigated in our case prior to the decision by the Supreme Court in *Omnicare*. We actually settled shortly after the Supreme Court had granted certiorari. Um, the prior case pending at the time in the Second Circuit which was *Faith v. Regents Bank*, actually has been abdicated mostly by *Omnicare*. I'm going to get to that in a little bit. I actually prepared some slides, um that you have and you're welcome to read. I think I'm not going to follow those exactly because I don't think they were quite as interesting. My slides mostly dealt with how district courts are grappling with, um, the Supreme Court's decision in *Omnicare*, and um, perhaps against what a lot of the commentators predicted, *Omnicare* does look to be a plaintiff's oriented decision. Most of the decisions have gone in favor of the plaintiffs to date. Although, it may not be a fair sampling, frankly, and one of the

reasons why is because all the cases that are pending at the time the *Omnicare* decision, have largely gone through substantial discovery. Um, where one of the things the Supreme Court looked at is, whether opinions are honestly believed. Are they firmly believed opinions by the company and are there potential red flags that should have given the company notice, um, put the company on notice not to make certain opinions. Um, a lot of those facts can be determined in discovery. A lot of the underlying red flags are things that are the subject of discovery. Whereas in an initial complaint, given the high pleading standards under the Private Securities Litigation Reform Act, a lot of those facts are not going to be known at the time of complaint is filed.

The full impact of *Omnicare* is not been borne out yet, but certainly the indications are that this is unlike prior cases the faith decision created a bar, or a prohibited, uh, companies from being sued based on pure opinion. And *Omnicare* certainly, overrules that. A couple things I think that are important, some of the teachings from *Omnicare* and frankly, these are mere old common law decisions. First, the half-truth doctrine. You know, important to advise your clients, when they speak they have to speak fully and honestly. You can't say something that's an opinion now if you don't really believe it or you have reason to doubt it. And that's something that *Omnicare*, uh certainly keeps open as an avenue for liability. Um, and importantly representations contained in opinions. Opinions that are based upon, that are based upon current facts, have to have a proper basis, and that's something that's going to be tested under *Omnicare*. Mark, in your experience, are the district courts willing to give you early discovery?

Mark Newman: No. In fact, the Private Securities Litigation Reform Act (PSLRA) was passed in I think 1996. It was actually a Congressional override of a President Clinton veto. It's very conservative, support for that Act. Provides a statutory stay on discovery until after a motion to dismiss is ruled on by the district court. So, unlike run-of-the-mill individual fraud claim or breach of contract claim, there is no discovery until a 12(b)(6) motion is decided.

Mark Kowalsky: And what are the methods for you to obtain the information you need to respond to that type of motion?

Mark Newman: That's kind of the trick of the trade. What you're seeing a lot of plaintiff's firms do is very aggressively, uh, hire private investigators. You know, we spend a lot of time looking at public statements as well as earnings reports, earnings conference calls. Um, analyst's reports for any clues of information, but also there's a lot of very good private investigator firms that specialize in this are that will actually try to get in touch with former employees and customers of defendants to try to obtain that information outside of the context of discovery.

Audience Member: What would be an example? Let's assume an investigator is looking at something of a statement that you would say would create liability under *Omnicare*---an opinion that goes beyond--

Mark Newman: So I wanted to kind of share what actually happened in my AIG case. They were really two specific---you know the case was very complicated and involved a lot of various, allegedly false representations. We had Section 10(b) claims as well as Section 11 claims. Section 11 claims were asserted against not just AIG, the issuer, but also against all the underwriters. I think there are roughly 15 different underwriters. There were a lot of offerings of AIG stock. It was one of the top five traded companies in the world for five or ten years prior to their bail out. We also asserted Section 11 claims against the underwriters as well as individual Directors and executives that signed offering statements, registration statements. But the two primary---and there's actually a published decision on this---relying on the prior fake decision but there were two specific statements that were alleged to be opinions. One, AIG, in case you lived under a rock for the last six or seven years had roughly close to one hundred billion dollars in exposure to the U.S. housing market---in what they called credit default swaps which were pretty complex derivative transactions. But AIG---up until the end of 2007 had never disclosed to the public that it had this kind of liability---had this kind of exposure and it ultimately lead to their demise.

They had, leading up until the government's bailout had posted something like 90 billion dollars in cash, collateral margin calls, that their contracts required them to post. A number of senior executives testified that they had no idea even existed in these contracts.

So, there were two allegations under Section 11 pertaining to this exposure. One was under accounting rules. There is a requirement to disclose significant concentrations of credit risk. And the other is an obligation to disclose guarantees. And you know our position was that obviously the concentration and risk they had to the U.S. housing market was significant and required disclosure---given some evidence in the case which suggested that their exposure more than exceeded their entire, their exposure just to the U.S. housing market exceeded their entire shareholder equity. And the court ultimately found that the determination whether credit risk concentration is, quote unquote significant, is ultimately a judgment call---is ultimately an opinion and it dismissed that claim under the *Faith* Case. And also that the obligation to disclose a guarantee---to determine whether a contract and contractual language constitutes a guarantee---is again a matter of judgment and that was an opinion. Of course they never---these were really omissions, they were not disclosed---but the determination whether to disclose them or not the court found was indeed an opinion.

Under *Omnicare*, I believe that decision would be reversed. Again, we settled the case before we got an ultimate determination on that. We got a very good result so. I think it's probably considered the number one---this year at least---as we sit here today it's the highest securities fraud settlement in the country, 970 million dollars. So hopefully that won't be surpassed this year. The court's determinations---whether the credit risk, whether there was significant concentration of credit risk---we had a whole host of evidence that we had discovered during the five years or six years of litigation that showed that AIG was very well aware of what their concentration of credit risk was and that the company, and the company's auditors never made a determination, didn't frankly even know that that credit risk existed, so they had no reasonable basis to make an opinion whether it was significant or not. And under *Omnicare* I

believe that would ultimately be reversed. And the same is true about guarantees. Senior management testified that they had no idea that these contracts even existed within the company and therefore how can you make an informed decision to render a good faith opinion as to whether these are guarantees that have to be disclosed.

So I think those are some examples where again, you know, just because you call something an opinion, the court is going to test whether it implies facts that are objective. That doesn't even fall under the *Omnicare* test at all. Second of all, the opinions that are expressed have to be honestly believed, have to be fully disclosed. You know, I think those are the biggest takeaways from *Omnicare* and something that hopefully you can use in your practice. If you're interested, my slides do go through three cases that were all decided in the last three or four months. Merck securities which used very similar issues and similar holdings to what I express with regard to how I think the AIG case would come out today. That was a complaint that or was a summary judgment motion that was denied and the plaintiffs prevailed on that. A Lehman Brothers case which also involves the financial crisis. It was Lehman Brothers which failed in September of 2008. Again, the plaintiff's claims were sustained on that case. And a Bioscript case, same thing---plaintiffs' claims were sustained. All under the similar logic that I've expressed. So, you know, the early results seem to be that *Omnicare* is a win for the Plaintiffs' Bar. And it's something that if you're a practitioner, you know, advising clients on Securities registration statements, something that you, you know, need to take heed of.

Unidentified Speaker: So if the manufacturer said: we believe are widgets are going to be well received in the market will have a long life, you know they're of terrific quality, et cetera, et cetera, and your investigator goes out and finds out that the retailers are saying this widget is a dog. No one is buying it. They're getting all kinds of warranty replacement requests, et cetera, et cetera, we've got an issue.

Mark Newman: It's certainly something that *Omnicare* leaves the door open to liability to the extent that it’s a forward looking statement that

raises all kinds of other issues and there may be a safe harbor for that. But again, it has to be honestly believed opinion by the company and if there is red flags, or the company has reason to know that their opinions are not truthful, that's going to create liability. And so it creates, it does create I think a reckless standard as you seem to indicate. Section 11 is a strict liability standard but the exception to that is that opinions now are going to be subject to a reckless---you know, did the company, was a company reckless in disregarding red flags about the facts that are contained within its opinions or about those facts upon which it's opinions are based.

Mark Kowalsky: Actually that is going to probably be the most litigated issue because the Supreme Court says that investors expect there will be contrary evidence. Contrary, but that the opinion is a comment. Mark's job would be you say whatever is contrary, was so contrary that it makes it false. It's going to be an interesting aspect of litigation.

Mark Newman: Let's move on to the next topic.

Clarence Pozza: Someone says, Michigan 24, State 3. I will and it doesn't happen, do we have an *Omnicare* case? When I left Ann Arbor this morning, the sky was blue and looking out I see blue sky between those clouds. I have a Maize tie on. But my son is a State grad so someone in the family will be happy tomorrow and buying dinner. While I'm doing a little update on Ponzi schemes. I was here a number of years ago and spoke about Madoff, the Stanford case and whatever. Tom Cox and I worked with the Michigan State Law School. And Elliot, congratulations. You know your program here in the school is innovative and you're really top drawer. Ray, great job. And Joe, a founder, great job.

Tom Cox and I wrote an article that actually has been cited---not in the Audubon Society, a Journal---but in a University of Pennsylvania Law Review. And we said that the world of Ponzi schemes really needs to harmonize. Somehow, the law that applies to victims and recovery and claw backs because common law, law of fraudulent conveyance,

creditor-debtor law, bankruptcy law, really isn't, it doesn't fit necessarily with Ponzi scheme recovery issues. And what happens is these cases get pigeon holed in a silo in some law and ultimately the results are quite bizarre. But it's the only law available in the cases---kind of shoehorned in. Well, a Madoff, you all know about the Madoff scandal. Fictitious account statements, he brought in billions and billions, it all went into one pot. There were no trades. How people miss that is simply amazing but there were no trades. But Irving Picard, after the Madoff scandal broke, became the trustee for recovery. And he did and he has done an amazing job. He's recovered about 55 or 56 percent. And he has been very imaginative in his claw back cases. So Picard brought a case---actually a whole series of cases along with SEPIC the Securities Investor Protection Corporation---and SEPIC and Picard went after individuals whom were without knowledge. They weren't part of a fraudulent scheme. They didn't know who had recovered not only the money they put in to the Madoff deal, but their profits. Even though this was all fictitious. So we have this group. Let's say someone put in a million. And the day before discovery they withdrew a million five, 500 thousand being their return--- fake return---and the same day an investor puts in a million and didn’t pull it out. Well under the decision I'm going to talk about, the individual who pulled out a million plus their return the day before discovery, got to keep it all---the individual who put in a million that day and got swept into after and ended up with fifty six cents on the dollar. So you get these incredible extremes in results with respect to the poor investors. And if you think about it---and for the students here---this is an area where at some point maybe one of you are going to be drafting the uniform Ponzi scheme Act that Congress will pass. It would be a job because you'd have to get the SEC and SEPIC and states and the bankruptcy committee you'd have to bring a lot of folks together. But this area is just a mess. And it calls out for something like the Uniform Commercial Code or something---some type of guerrilla law---that could be applied an equitable driven law. Equity driven that somehow works this out. So the decision. SEPIC in a big press release last March said that they joined Madoff in petitioning the Supreme Court to overturn a roadblock to recover fictitious profits. Well two months later---their tail between their legs---the high court blocked the bid for claw back and

here's what happened. Judge Racoff and let me let me move ahead here. OK. Pickard and SEPIC took whole bunch of investments trusts and the the. It went through bankruptcy. Into the bankruptcy case and the bankruptcy judges basically deferred. And ultimately the case ended up before Judge way cough. Who has become very very popular and famous and. I push which one to move it to the next. You're going to do it. And his decision basically is timing is everything. Get out early. Pre Bankruptcy. Get your alleged fictitious profit out. If you're going to be good. We go to the next. OK so. Pickard as trustee sues to recover these fictitious profit. people who got their money out within two years of the bankruptcy. And that's an issue. Because under some state fraudulent conveyance acts you can go back many years bankruptcy. Two years. So Pickard trying to claw back these monies. And he said that there are what about transfer transfers and the bankruptcy at five forty eight one a be a. One is the fraudulent knowledge standard. B is a constructive knowledge. He said of these folks have been far too narrow. Because of actually one. Know him and he argued that by forty six the bankruptcy Act doesn't apply this isn't that complicated. You'll understand a movement by forty six easy sounds. In bankruptcy. A set aside Of securities transfers. And payments gauge in connection with the securities contract for Settled of payments and the theory is lets think about Lehmann Brothers. Lehmann goes into bankruptcy. If someone tried to undo. Those millions of transactions they had done in the prior Two years. International, domestic, whatever. Would be a total mess. So Congress said. Five forty six E. You cannot in bankruptcy set aside if there is a securities contract. You cannot and transfers and payments pursuant to that contract. You cannot set those aside. Elliot can we go to the next one. OK So here's the rub in this the. The theory behind five forty six e makes sense in a massive Lehmann Brothers. in Madoff though. Even though the court said Madoff. And his firm. If they own wound these transactions. It would create. All of these dislocations. Your reality is made off steel compared to a layman brothers was. You know a drop in the Grand Canyon It wasn't that huge a deal. But they have the philosophy. Under five forty six e and you the Congressional intent. And even though there were no trades. There were no true prophets there was not a true Securities transaction. Judge rake off the

Second Circuit. In the Supreme Court in denying cert held that those transfers of even fictitious profits were exempt from a claw back under the banker's code. Nesting into five forty six e. He because essentially every customer signed of a customer approved trading authorization and an options agree. Those were the only real things in the whole NATO. three contracts that the customers signed and everything else was fake. Except that cost a little positive. IN THE MONEY coming out of the courts said. Five forty six e kind of trumps everything. Even though this is all fake There was a securities contract. And the courts concluded that the transfers of the funds out. Were made pursuant to the securities contracts. They were executed. And therefore couldn't Picard and SIPEC could not claw back those funds. So that individual who got out their million and a half. Got to keep it even though. Half five hundred thousand was fictitious and poor individuals or couple that put their million in That same day. But didn't take anything out. They got stuck in that giant sea of claims. And they're getting their fifty two to fifty four percent. Now hard cases make bad law that this is the kind of thing. Tom and I wrote about a number of years ago. And I just I find the Syria fascinating it. It just really is something. These decisions keep coming down Picard is still pursuing billions and billions more so there will be more cases coming. And some I think of the more interesting cases. This week. A trial jury trial started against Ernst and Young. Which was the accounting for a feeder fund. in the feeder fund is saying that Ernst blew it in not detecting the made off scheme in their audit of the feeder funds I I think it's a stretch but who knows I be a but it's going it's it's before a jury trial. I do have to say I would have gone. The other way I would have said that five forty six. E. Doesn't apply here. Even though there's a contract. All this stuff was fake. And Congress couldn't have intended that five forty six e. Be exempt everything. But just like my opinion about the game tomorrow. The second circuit in the U.S. Supreme Court would reverse me. But go blue. Great game and hopefully the boys tomorrow come out without injury and we have a great day.

Unidentified Speaker: Going back to your earlier statement would you say that tomorrow it will ruin my day?

Clarence Pozza: Yes, those Wolverine fangs.

Unidentified Speaker: In that Ernst & Young case. Where they're claiming that the auditors may not know. Then wrote it and that that would you go and been run say. They had an obligation. They've missed. Eight times. Trying to get made off. You know how to get a ticket. Accountants. Make them. Which sparkled with you exactly.

Clarence Pozza: Well there. There was a you know there FCC. was throughout and you all seen the news whatever really since he looked at it and they said there investigators were were a fool that cetera et cetera. You know I don't know Doug I haven't looked at that. With respect to the F.C.C. or or FINRA like FINRA and a lot. And the FCC. but I don't know if I don't know all of it or think think for a job they can just time.

Elliot Spoon: Both FINRA and the F.C.C. were sued. Both cases were dismissed because of immunity issues with respect to both of them. And I really would think that if the F.C.C. or the FINRA Representative up here. They would say our role in our ability to un cover is much different than the auditors. And their relationship with the auditors. Any more questions for these gentlemen yet Jeff?

Unidentified Speaker: Are you probably I mean. Normally the FCC has governmental immunity.

Elliot Spoon: without getting too far it's a quasi. Well it's a quasi governmental role that they're there. That they have and. This is a discussion for another panel on another day. Why don't we bring up that we switch your house thank you thank these gentlemen. We're just going to run right into the arbitration panel can somewhat stay on time here.

Panel 6: Securities Arbitration Developments

Unidentified Speaker: Why don't we get started. Yeah. If you in mind getting seated, we'll get started here so we can keep moving this along here. The final panel is the securities arbitration panel. And on the panel today we have Joe Spiegel. Joe's obviously a long time participant in this presentation. We also are very honored to have Felicia Fox from FINRA who's a longtime participant. We really enjoy and appreciate her coming to speak at this presentation. Jonathan Sterling from the Sereski Firm is also with us today and Dan Boxup, am I saying it right?

Dan Broxup: Broxup.

Unidentified Speaker: Oh I'm sorry Broxup, is also here. Dan also works with Eric Richards on the MSU Clinic, Arbitration Clinic. Would you like to just say about two words about that so, introduce that to practitioners who may not be familiar with the clinic that MSU has that is very valuable.

Dan Broxup: Yes So I'm co-director of the Investors Advocacy Clinic with Eric Richards as right mentioned. Basically what we do at the clinic is we supervise student clinicians and we bring securities arbitration cases that ordinarily wouldn't get followed because they're low-dollar volume, and so we bring those cases. We also handle expungement cases and I'll be talking about expungement here today, but we represent claimants, customers, and investors in expungement cases as well. So one thing I would ask if if anybody comes across potential clients and the small claims of the plan in a possum when they hear of small claims the clinic is always looking for potential clients, so we very much welcome any referrals.

Unidentified Speaker: And I have some experience with the clinic they're doing terrific work. And I really encourage you to increase their caseload if you come across small cases. Joe you want to take us off?

Joe Spiegel: We're going to cover this afternoon. By the way almeries means you come last. Used to be lot further up the chain. We're going to cover three topics. Confidentiality, a little bit on the discovery and then we're going to move into fiduciary duty. And then we're going to go into broker dealer and investment visor, what I like to call the bleach taking

these claims out of the record for expungement, and then Felicia's going to talk about an update. In the corner there is a package, if you don't have it. Confidentiality Agreement Standard Michigan Form. Tony Trojan worked for about a year putting together a standard Confidentiality Order, under the theory that we don't have to invent everything again and he did a great job and, it's pretty much been adopted by everybody. What I added to the confidentiality agreement provision, Oakland County has a standard protective order and a claw back provision. I thought that where you have a claim that is significant, and you have the money, and both sides are engaged in electronic discovery, E-discovery, this is the type of claw-back provision that I think would be beneficial. So take a look, both at the standard form as Jonathan knows as all the firms know I don't do e-mail. But if you e-mail Jonathan...

Jonathan Sterling: I'll fax it to Joe. *[Audience laughter]*.

Joe Spiegel: Jonathan can email you a version of the Michigan standard confidentiality form. What I would like to also director attention to is the FINRA guide; the arbitrator's guide and I cut out pages. Thirty, as exhibit three, thirty to thirty-nine. And what this does is outline for the arbitrators, and I really encourage you to read this. The do's and don'ts of depositions confidentiality, discovery but what is really important is it digs into product cases. And when and how you should engage in E-discovery. I would suggest that. Out of the six thousand cases the generally filter around the FINRA arbitration process. A very few, except for the large dollar volume cases, involve E-discovery. And what I have thought for some time is, the arbitrators themselves are not familiar with discovery they don't understand the costs. It's not their business. So one has to educate the panel on E-Discovery. If you're going to engage in it and in my presentation in writing I set forth a definition of good cause. When is it that you're entitle to this E Discovery, and there's been significant amendments to the federal rules. And there's a famous case called the Zoo Block Case and it is a case that was brought against U.B.S. by an employee, and the judge, Sarah Shindlen, she's made a career out of this case. She now is the premier E-discovery judge in the country. And on page two, I set forth the seven tests on who should pay. Who should pay for this discovery? She has suggested, publicly, that the Sedona Conference Journal has a certain amount of resources that I have set forth that's all on the Web sites. As to who pays, how do you go about it? But I would suggest that you read the Rand Institute for Civil Justice. It's a publication, where the money

goes understanding litigate expenditures for producing E discovery. There is this concept called Predictive coding, keyword or boolean search methods. I really encourage you to understand what you're going to ask for, because there are three cases. I'm just going to give you the citations Victor Stanley v. Creative Pipe; 250 F.R.D. 251; William Gross Construction v. American Manufacturing, 256 F.R.D. 134, and Dalia C.V. Moore v. Publicist's 287 F.R.D.182. I'll tell you what the case is say, whether it's a federal district court judge or magistrate judge. The cases say we don't know. Go figure it out yourself. The courts are not going to get into the nitty gritty of E-discovery. So how is it that arbitrators are going to get into the nitty gritty of discovery so your job as a claimant's lawyer is to be very specific as to what you want. And you have to be conscious of the defendant's or respondent's position. Because the respondents have this vast warehouse of information. And the arbitrators are going to say well wait a second this case is fairly limited. It's involving maybe one or two products one broker. Are you going to cause hundreds of thousands literally hundreds or thousands of dollars in costs to search out Electronic discovery? I mean there's truly a balance that has to be made and you better be careful what you asked for because there's always these unintended consequences so for example if you ask for something. And there arbitrators give it but the arbitrator say you have to pay half or you have to pay three quarters. And you can't. How does that affect your case? So I am, I think that these materials are around the corner. I think that it will essentially give you everything you need to have as a start for electronic discovery. One of the other issues that I find fascinating is some of these cases. There are processes where the person providing the E-discovery will not look at it all they will put in certain terms like attorney client ect. And they will say to the other side. We have made our best effort to cull out all the attorney client privilege material. And low and behold the strategic importance document gets sent with the other material in the discovery. So it's kind of out of the box now and under the A.B.A. you have to return it, but you already know about it. These are our real problems that are popping up in some of the large dollar cases. Sampling of emails may not be sufficient. And this also goes for claimants. So what I'd like is Jonathan. To talk about this concept called fiduciary duty. Now. I will say that Mr. Trogin and I believe that every broker and every investment advisor, and anybody who's seen an investment advisor has a fiduciary duty but Jonathan's going to take a position…

Anthony Trogan: I don't think so, but if that's OK, I have something for

the slides

Joe Spiegel: Yes yes. Thank you.

Jonathan Sterling: So hi everybody I'm Jonathan Sterling thanks for being here still I know it's late and I will try to talk fast to get you guys out here at four o'clock. I was asked to talk about fiduciary duties and how it works within arbitrations. You know kind of first thing first is you know who's involved in the sale securities because it depends on who you're dealing with as to what duties if any there are. Immediately there are a lot of acronyms in securities world there. You know and so we're dealing with that here you've got registered representatives or broker dealers who we call B.D.'s and these are, these can be people with independent contractor relationships or employees, and you know typically referred to as a stockbroker. They're paid commissions and they're registered and regulated by FINRA. And then there are advisers, Investment Adviser, Representatives IAR's of registered investment advisors RIAs, which they generally revolve around overall portfolio strategy. As opposed to being commission based, they're fee based and their registered and regulated by the states in the F.C.C. So the question is who knows the difference? In 2011, in response to the DODD Frank Act, The F.C.C. did a study and basically what they found was that, that investing public in general doesn't know the difference. Right? They're dealing with a financial advisor or a stockbroker and they have no idea that it really does matter because if they're, if they're dealing with somebody that's a registered representative, the regulation it's much different. And so you know that's kind of what we what we deal with RIAs, investment advisor representatives of RAs. They have, they are fiduciaries; they must act with loyalty and utmost good faith. Essentially they have to do what's best for the client. It's not what's best for them, it's what's best for the client. And it's always that way. They have to disclose all conflicts. And that doesn't that doesn't change. It's different with a registered representative, which is what I typically deal with in FINRA and FINRA arbitrations. Generally register representatives are not fiduciaries they're not there's no statute that says that they are in different states have different feelings about it. In Michigan where we are obviously the current law is that registered representatives are not fiduciaries unless they have the authority to buy or sell the account, so unless that you have a discretionary account you sign an agreement giving the. The advisor complete authority to make trades on your

behalf without calling you in advance. But if you don't have that and that's a non-discretionary account the visors generally is not considered a fiduciary. So when dealing with those non-discretionary accounts what do you have to do? It's a suitability standard. You have to. You have to make a suitable recommendation and what's suitable isn't necessarily always the best or the cheapest but it just has to be suitable. And you have a duty to recommend the investment only after becoming informed about it and your customer, you have to know who you're dealing with OK. and then you have a duty to carry out your customer's orders and to inform them of the risks. But again you, there are a lot of different options that are available to advisors or registered reps to sell to their clients and it doesn't have to be. The “best”. It just has to be suitable. It's different with a discretionary account like I said when you have got a discretionary account you're managing that account. Kind of going back to non-discretionary. If you sell somebody a security and then you know you're done. Once the transactions consummated you're done you don't have any obligation to monitor it, OK, versus if you have a discretionary account. You have to, you have a duty to monitor it so it has to be suitable when you recommended it but it has to stay suitable and if it's not. You have to you, have to, speak up and you have to make some changes. But in a non-discretionary account that doesn't have that doesn't happen. The adviser doesn't have to pick up the phone and say you know what, there are some things change we should do something. Now some, Joe and Tony, would argue that they do have to pick up the phone and they should have to pick up the phone. They don’t, but, and that's just the way it is. So I don't know if any of you are seeing the news I get a bit e-mails by investment news and seems like every five minutes I get bombarded with a new e-mail. And so I see a lot of the Department of Labor's proposed to fiduciary rule. And you know I like that. You know President Obama, he came to the table and he said you know you want to get financial advice. You've got to put your client's interest first. So the Department of Labor and a lot of people have asked why the DOL is doing this and not the F.C.C? The F.C.C. and it is working on it they just, it's been slower than I think some people would like or want. But essentially what they're trying to say is that when you're dealing with a risk of plans and if you're dealing with anybody that has an IRA and most advisors, you know a significant portion of their of their book of business is IRAs. And so it. This really affects them. And basically what the DOL is saying is that you need to go to a best interest. Standard. So I don't know if you guys so appropriate?? over there. But apparently he makes this comment what. So it's not it's not the DOL’s rule isn't you know doesn't change who's considered a fiduciary. I'm

sorry it changes who is considered a fiduciary and not the standard of care. So again it goes to this best interest standard. If you give individualized advice if you receive compensation and it's whether it's a fee or it's a commission. The deal well what have you, have you, be considered a fiduciary. So there are various, different groups that have positions on this one of them is the PIABA, public investors arbitration Bar Association. That is the claimant's bar. These quotes come from the president of Piaba and in your handouts you have a bigger presentation thank you to Ray because if I was going through what I originally gave him we'd be here to like six o'clock with all my slides. But I've got more information in there with all of the sites to all of these things but the president of the PIABA has basically said you know they're all from the DOL's position. They believe that it should the best interest of apply you know across the board. That the suitability rule is ambiguous and doesn't make sense. And one of the things that they'd also like to see done away with these mandatory arbitration clauses because in all of our cases you know a lot of people don't realize it when they went and signed up with their investment advisor. They don't know that in the fine print that there's a mandatory arbitration clause but it's in force of law, and you know when we see somebody filing in court where there's that arbitration agreement. Most of the times it's going to get compelled arbitration and a lot of times it gives you know the defense attorney and you know there might be a tactical reason for it but a lot of times it shows me that I'm dealing with somebody that doesn't really know what they're doing because there is that agreement and they are enforceable. FINRA supports the best interest standard and if anybody has a solution maybe they should say something but probably not, but they do believe that it does. It doesn't officially build on the existing system in other words. It's going to be very hard to regulate and it's going to be very hard for broker dealers to adapt, and so the concern is that if the DOL positions adapted that, broker dealers were abandoned small accounts and so the you know the mom and pop investing public, they're the ones that are going to be harming the middle class. There's SIFMA, the Securities Industry and Financial Markets Association that's kind of like the defense bar. They are. You know SIFMA believes in it and the best interest dander, but again that they believe that the proposed rule goes way too far. And it's not going to be able to be enforced and it's going to create a major problem for broker dealers to get up to speed fast enough in order to it to comply with the law, The SEC. There's no formal position that's as I'm sure that you've heard today from the various S.E.C. speakers. Their positions are their own and do not represent the SEC. But informally, commissioners have stated that they believe that it will harm

investors in the U.S. capital markets that it's going to be too difficult to navigate and limit choices to investors, and then also like I said, one would ask why is you know why hasn't the SEC done something at well the SEC is working on it? And so there's you know it's going to be interesting to see what happens when the SEC comes up with something, and whether or not it contradicts with the with the Department of Labor. So I'm sorry from talking fast again. Going to get you out here in time. So what's it mean to finish an arbitration? Nobody really knows. And I said every day I get a different e-mail and they're working on it. Mr. Spiegel and Mr. Tropinin, they claim its attorneys are always going to say, no matter what there's a fiduciary obligation. No matter what. And the attorneys like me are always going to say there's not, but if there is our client satisfied it. You know simple as that there are anyone who practice and is practices in this field knows that when you get an arbitration award. It doesn't tell you what the reasoning was behind it the arbitrator's aren't required to give you an explanation. We have several FINRA arbitrators here in this room. And I think that you know at the end of the day arbitrators tend to do what they feel is right. FINRA, you know it's an arbitration, it's an equitable forum. And so if, if the arbitrators believe that the investors have been harmed in that you know there's fall. They're going to get an award. And that's that just kind of you know at the end of the day I think that they're just going to do what they think is right and I don't think that the DOL, the DOL rule is going to change that. At the end of the day there you have it. Thank you, thank you all.

Joe Spiegel: Now you have to understand something. No one has said why it's going to cost the industry more money. No one's made an analysis, no one's put a dollar figure on it.

Jon Sterling: Wait a minute Joe. That’s not right.

Joe Spiegel: Of course it's right. You know the government hasn't said it's going to cost A, B, or C, and so one has to wonder you know why there’s this polar view of the fiduciary duty. It will be worked out I assume in the next year or so or two. The biggest problem we have here is that Mr. Mark Newman and Mr. Koalski and Mr. Poses they get to go to court. But there hasn't been a body of law relating to customer, broker dealer, customer investment advisors developed in the last 30 years ever since mandatory arbitration came into existence. And I think that has done a disservice to the industry. Now, Dan is going to talk to you about

bleach. What do I mean by bleach? Well you know there's a ding on this record and we want to get it off we're going to bleach it no one's ever going to see it again, and that's after someone has deigned to broker and gotten an award. Dan?

Dan Broxup: Yes. So, expungement has been a pretty active area for FINRA even within the last couple of months. There's been expanded guidance issued for arbitrators. Just a little bit of context, I think Joe provided some but basically what we're talking about here is when a broker a complaint is followed against the broker by a customer, he gets a black mark on his record. Then he has the option to try to get that black market expunged. As to follow a motion for expungement, the grounds, the substantive grounds, for doing that are very narrow basically in a nutshell. He has to show either that the claim is false or that it was clearly erroneous. All this one other ground is basically boils down to he was not involved in the sale practice issue. FINRA has said that expungement is an extraordinary remedy, it should only be granted in cases where there's no possible investor protection benefit, evaluable from having that record out there. Procedurally FINRA has some rules in place; there has to be a hearing. If the panel wants to find in favor of the broker than the panel has to issue a written opinion, which is unusual for FINRA. And it has to explain which specific substantive ground the panel is relying on. Another interesting procedural requirement is the panel has to review any settlement agreement that is in place between the customer and the broker. So even if you have some kind of non-disclosure provision in your settlement agreement, it can't cover expungement and that was actually a rule that came out last year which I'll touch on very quickly, but the expanding Gardens touches on a lot of the procedural issues that were in place before it reiterates that the standard is an extraordinary remedy but adds a few new details and one of the points to make is this came out and September. At the same time or within a week or so, FINRA board of governors did vote to make some changes to the rules so that will then be kicked up to the SEC, and at some point we may see some real amendments come out that is likely that the role is probably just going to codify a lot of what is in the garden said. So I think there are really five things to touch on in terms of the new gardens and I'll do that very quickly; the first one is the role of the claimant or the customer or the investor in an expungement hearing, and the guidance makes it clear that the customer or the customer's representative has the right to present opening and closing arguments, to cross-examine the broke, to introduce documentary evidence.

I believe that one thing that was an expressly stated is the customer's right to call his or her own witnesses including expert witnesses, but I think most panels would agree if that was helpful they would allow that evidence in so that's now been put in writing, and it's clear that custom has a role to play in an expungement hearing. One other feature that's been added I think to really protect customers. Sometimes brokers will bring expungement cases without naming the customer's party, just naming the brokerage firm usually that cry a brokerage firm as a respondent and those cases arbitrators instructed to instruct the broker that he should serve a copy of his motion paper's to the customer. That way the customer has notice of the hearing. Opportunity to be there and obviously to oppose it, if the customer wants it.
Couple of small details that were added. Arbitration panels are now instructed to prior to issuing any award they should review the entire broker check report for the broker who's asking for the expungement relief. That's a new feature-- one that I think is hilarious that had to be put in writing, but you only get one bite at the apple as the broker. If you lose, you can't then going and file the same expungement motion and try to get a different panel and get expunged-- you get one opportunity. That leads me to believe that more than a few brokers probably tried--tried to go back for a more favorable panel.

Then the final, yeah the final, I think topic worth, just briefly touching on, and this goes back to a 2014 FINRA role and I've touched on it already. That it can be a condition of a settlement that a customer will not oppose and expungement motion. If an arbitrator reviewing the settlement agreement sees an express clause to that effect or discerns it throughout the hearing, is encouraged to then make a disciplinary referral FINRA. [E1] So those are kind of the highlights that as I said it's a September release is pretty easy to find, you just Google: Expungement and FINRA and that will be the first thing that comes up.

Audience Member: Dan, let me ask you something and you can chime in. As a strategic matter where the claimant is not named the broker. When do you ask for expungement? Any opinions from the panel or from you Ray?

Unidentified Speaker: I think it is a real difficult situation for the broker because typically in those cases settings in house counsel is representing, or someone is representing the firm, there not representing the individual and they may not make the case for those grounds for expungement, or

maybe persuasively; they are trying to win the case for their firm. So if you have the in-house counsel ask for the expungement, it's not going to be a level of advocacy for the individual. So if they don't do it then. Gerald, as you know, then you have to hope for an award dismissal , a no cause award, and then bring another petition for expungement at the time, and redo the whole thing. And you also have the possible situation where the individual involved, who was not named, no longer works at that company. Right, so they won't even have an opportunity. They have no opportunity.

It's a difficult strategic problem for the brokers and it's not really fair to the brokers especially if they're not named and they really did nothing wrong-- let's say it's a product case, that the product went south the broker had no knowledge, didn't understand it, it really isn't his fault. But under the current system, it's a ding to some degree on his or her C.R.D. Felicia's going to talk about the task force and what's coming up.

Felicia Fox: Okay. Good afternoon everybody and I know we're late so I'm just going to try and hit the high points here. But first let me just give the standard disclaimer here that everyone else did and you've already heard. But any opinions I might give today are my own and not necessarily those of FINRA or my colleagues. So let me go right to the task force. The task force was formed in July 2014. And its mission is to suggest strategies to enhance the transparency, efficiency, and impartiality of the FINRA dispute resolution process for all participants. The task force is composed of a diverse group of participants including leading investor advocates, regulators, industry representatives, and academics. They're all working together to help ensure that FINRA's arbitration and mediation process continue to meet the needs of the investing public.

The task force is composed of thirteen people. Seven of them that are current arbitrators. The task force published an interim report in June 2015 and from that interim report I'm going to hit some of those highlights. They do make it clear it's just an interim report and they're free to change their minds. Those issues that are highlighted in the interim report might not necessarily be the same as in the final report. They did just meet in October and the chairperson is in the process of drafting the final report at this point. That will be put on the FINRA website and it will be presented to the NAMC. The NAMC is the National Arbitration and Mediation Committee, which is FINRA's

standing advisory board. It includes both industry and public participants.

So, a couple highlights from the interim report: by way of background, the task force solicited comments from the public and users of the forum. A lot of arbitrators participated in the comment period and gave us suggestions for improvements. The task force is likely to recommend improvements to arbitrators in three categories including recruitment, training, and disclosures.

In regards to recruitment, we're looking at aggressive recruitment with a view toward increasing the depth and diversity of the FINRA arbitration roster, as well as streamlining the registration process for arbitrators. As far as training, we're looking at continuing education on a regular basis, along with specialized training courses and additional training for inexperienced arbitrators who haven't been selected recently, or arbitrators who might not have received the most favorable reviews. As to disclosures, there have been concerns expressed that not enough information is being provided by arbitrators. Questions being explored by the task force are: What information should be disclosed by the arbitrators and when should it be disclosed?

The task force is looking at timing so the information is provided at an early stage rather than after the panel is selected and a party would have to assert a challenge for cause. Toward that end the panel, excuse me, the task force is also looking at voir dire, and they are looking at proposing sample questions that might be appropriate to ask of arbitrators. Also under review are explained decisions. The task force is looking at encouraging the greater use of explained decisions, and again that relates back to training. So they are suggesting additional training of arbitrators so they will be able to write an appropriate explained decision. They are not suggesting that arbitrators write opinions. They are not suggesting that they are looking to create body of precedent. However, they have received comments that the process is too opaque. And the goal is to increase transparency, so the task force is looking for possible explanations of why a panel decided the case the way it did, maybe short fact based explanations. They're not looking at encouraging the citation of legal authority, but perhaps more with the focus on damage calculations and how panels arrived at a particular number.

Currently, explained decisions are only used if both parties agree during a particular stage of the case. Very few have been requested to date.

The task force is looking at changing that presumption to where parties would automatically receive an explained decision unless somebody opted out, rather than the way it is now, which is an opt-in.

Regarding expungement they are looking at developing special arbitration panels to hear expungement cases, at least for cases where there hasn't already been a hearing on the merits. They are looking at having arbitrators who are especially trained with FINRA guidance on expungement, who understand significance of CRD, and the importance of disclosure, and therefore, why expungement should only be granted in a very limited number of cases. They are also looking at changes to procedures for small cases. Currently, small cases are heard on the papers alone. And the goal here is to increase the parties' satisfaction, especially when the majority of those cases involve pro se parties. So they are looking at having a hearing. Maybe Skype, video, telephonic, some sort of short form hearing that would enable parties to present their case and enable arbitrators to better be able to judge credibility.

So, when might the final report be issued? They're looking at a target date of mid-December for that, and again that would be published on the website. So that's what I have, and maintaining everything neutral, I hope everybody's sports teams do well this week and especially the Cubs.

Audience Member: Felicia, could you tell people how one can become a FINRA arbitrator?

Felicia Fox: Yes. And the shortest answer is we have a link on our website. And there's an application there. It's pretty straightforward. We have experience requirements and a lot of disclosure requirements. And then there's also a background check process. And training. Of course training.

Panelist: Any other questions?

Audience Member: Earlier we heard about mandatory arbitration that really the public may or may not even understand when they sign their contract. We heard about no law for the last thirty years that has any credible relation to the customer relationship. FINRA governance is basically all the large firms and you don't really want to accept the fiduciary standard. Your mantra is market integrity and investor

protection. You have no inspector general who looks over what this task force is going to do and approves it. Does Congress even look at this or?

Unidentified Speaker: I'll take that. Congress does have responsibility for oversight that's not part of Felicia's responsibilities. And she couldn't even comment, even if she did, but it's a creation of Congress, Congress did have the S.E.C. oversight of FINRA--which is a quasi-governmental agency, even though it's private. And there are task force that review on a constant basis what they do. What you're asking, I think, is what their official position is on mandatory arbitration it's not for them to state. That's a congressional issue and with respect to inspector general they have their own internal ethics and their own internal responsibilities which the S.E.C. oversees. Any other questions? I leave it to the. All right well this was last but certainly not least. Thanks very much.

Elliot Spoon: On behalf of Ray, I want to thank you all very much for participating this year and we'll see you next year. Thank you.

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