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Investor Protections: Legislative Efforts to Bring the Balance Back

By Michael Petrusic

In September 2009, a subcommittee of the U.S. Senate Committee on the Judiciary held its first hearing on the proposed Liability for Aiding and Abetting Securities Violations Act of 2009 (the "Aiding and Abetting Act"). The Aiding and Abetting Act, which was introduced by Pennsylvania Senator Arlen Specter in July 2009, would amend the federal securities laws to provide a private right of action against secondary actors (such as rating agencies, auditors, lawyers and offering underwriters) for aiding and abetting securities violations. In so doing, the Aiding and Abetting Act would legislatively overturn the U.S. Supreme Court's decisions in Central Bank and Stoneridge, which preclude investors from bringing such claims in private enforcement actions. The Aiding and Abetting Act is one of a few significant legislative efforts taking aim at Supreme Court decisions that have whittled investor protections and the ability to hold accountable those who facilitate and substantially participate in securities fraud.

The Supreme Court's Decisions In Central Bank and Stoneridge

Prior to the Supreme Court's decision in Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A., investors injured by securities fraud had long been able to seek recovery from secondary actors who aided and abetted the primary violator in committing the fraud. To prevail on such a claim, investors essentially had to show that a secondary actor substantially assisted in the fraud of a primary violator of federal securities law. In its 1994 decision in Central Bank, the Supreme Court overturned years of settled precedent, holding that there was no private right of action to bring aiding and abetting claims under Rule 10b-5 of the Securities and Exchange Act of 1934.

Though Central Bank precluded liability for aiding and abetting claims, it did not necessarily preclude liability against secondary actors. Rule 10b-5(a) expressly prohibits the employment of "any device, scheme, or artifice to

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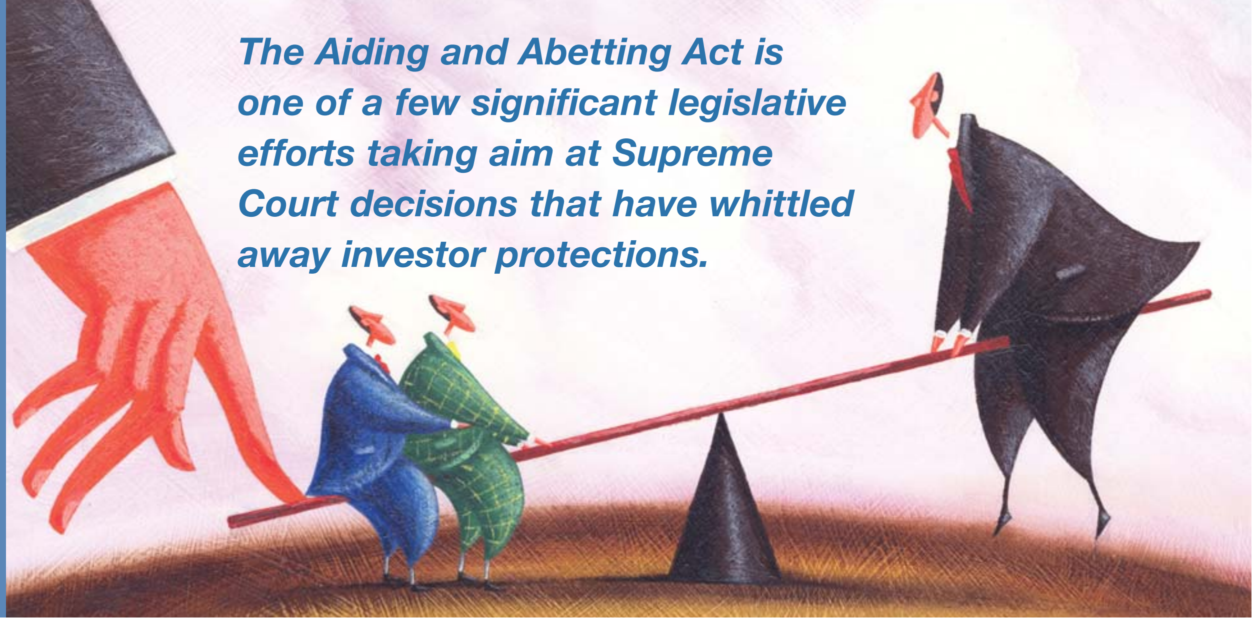

Inside Look

As economists and market observers debate whether or not the worst of the global downturn is behind or ahead of us, in this issue of the *Advocate*, we focus on several of the regulatory and structural reforms currently developing in the U.S. capital markets.

In our cover story, “Investor Protections: Legislative Efforts to Bring the Balance Back,” BLB&G Associate Michael Petrusic looks at the push being made in the U.S. Congress to pass new laws that would reinvigorate some of our most necessary investor protections — many of which have been watered down or altogether erased in recent Supreme Court decisions.

After an era in which the SEC was widely recognized to be at its least effective, its new leadership is fighting to once again become relevant and meaningful. BLB&G Associate Adam Wierzbowski outlines the recent enforcement push by the agency, and some of the obstackes it faces in “The ‘New’ SEC Comes Out Swinging.”

How to properly incentivize and compensate executives continues to be a central issue in efforts to prevent another financial crisis, and one with which regulators, directors and politicians perennially grapple. Amidst relative political consensus that something has to change, a new voice has recently been added to the mix. BLB&G associate Karine Louis examines the Federal Reserve’s push on this front in “Executive Compensation Reform: The Fed to Have Its Say on Pay.”

Max Berger

As long time *Advocate* readers may note, I am extremely pleased to introduce the new editors — BLB&G associates Ian Berg and Boaz Weinstein. Ian practices out of the firm’s California office, while Boaz is based in New York. In addition, as always, you will find a compilation of the most significant recent developments in securities litigation, regulation and corporate governance in our regular “Eye on the Issues”column by our new ‘Eye”editor, BLB&G Associate Katherine Sinderson.

Also, please note that we always make the current issue of the *Advocate* (as well as all past issues) available on our website at www.blbglaw.com. Many of our readers receive the *Advocate* via email and we encourage you to let us know if you would prefer to save paper and receive your copy in pdf format via email as well.

We trust that you will find this issue of the Advocate both informative and insightful. As always, we welcome your comments, questions and input.

Max W. Berger

INVESTOR PROTECTIONS

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defraud.” In the wake of the Supreme Court’s *Central Bank* decision, investors increasingly sought to hold secondary actors who participated in a “scheme” to defraud liable as primary violators under Rule 10b-5(a). For example, in the Enron securities litigation, investors brought suit against the banks, attorneys and auditor that assisted Enron to perpetrate one of the largest securities frauds in history on a theory of “scheme” liability. Because Enron was bankrupt and had no real ability to compensate harmed investors by the time the fraud came to light, these secondary actors were the primary source of potential recovery for injured investors. Investors were ultimately able to recover approximately $7.2 billion in negotiated settlements from these secondary actors.

In 2008, in Stoneridge Investment Partners, LLC v. Scientific-Atlanta, Inc., the Supreme Court essentially eliminated scheme liability for secondary actors in most circumstances, allowing even those secondary actors held criminally liable for their conduct to escape civil liability.

In 2008, in *Stoneridge Investment Partners, LLC v. Scientific-Atlanta, Inc.,* the Supreme Court essentially eliminated scheme liability for secondary actors in most circumstances, allowing even those secondary actors held criminally liable for their conduct to escape civil liability. The Refco securities litigation illustrates this point. The law firm of Mayer Brown LLP and former firm partner Joseph P. Collins helped the once-prominent brokerage Refco, Inc. conceal from investors close to $1 billion of uncollectable receivables through dealings with a related entity controlled by Refco's Chairman and CEO. The revelation of this fraud caused Refco to collapse into bankruptcy a mere two months after its initial public offering of common stock. Collins was criminally convicted of five counts of securities fraud for his role in the Refco fraud. Nonetheless, United States District Judge Gerard Lynch felt compelled to dismiss private securities fraud claims against Mr. Collins and Mayer Brown LLP, citing *Central Bank* and *Stoneridge*. Judge Lynch entered the dismissal despite his belief that harmed investors had "allege[d] facts that, if true, would make the Mayer Brown [and Mr. Collins] guilty of aiding and abetting the securities fraud that harmed the plaintiffs," writing that he would have been forced to dismiss the private civil claims "[h]owever significant a role the Mayer Brown Defendants played…and however culpable they may have been to do so with the knowledge that the transactions were ultimately designed as part of a scheme to defraud…Refco's shareholders."

In the wake of the massive Ponzi schemes conducted by Bernie Madoff and Allen Stanford, investors hold little confidence that the SEC can adequately enforce the securities laws against secondary actors. This is particularly true in light of public perception that the SEC has done little to target and pursue wrongdoers that helped cause the current global financial crisis.

Judge Lynch echoed growing investor sentiment by remarking that "it is perhaps dismaying that participants in a fraudulent scheme who may even have committed criminal acts are not answerable in damages to the victims of the fraud," adding that the Congressional decision to leave enforcement of aiding and abetting liability solely to the SEC "may be ripe for re-examination." Indeed, in the wake of the massive Ponzi schemes conducted by Bernie Madoff and Allen Stanford, investors hold little confidence that the SEC can adequately enforce the securities laws against secondary actors. This is particularly true in light of public perception that the SEC has done little to target and pursue wrongdoers that helped cause the current global financial crisis. As Columbia University Law Professor John Coffee testified in support of the Aiding and Abetting Securities Act, the SEC is "cost constrained, has limited personnel and a large backload of cases."

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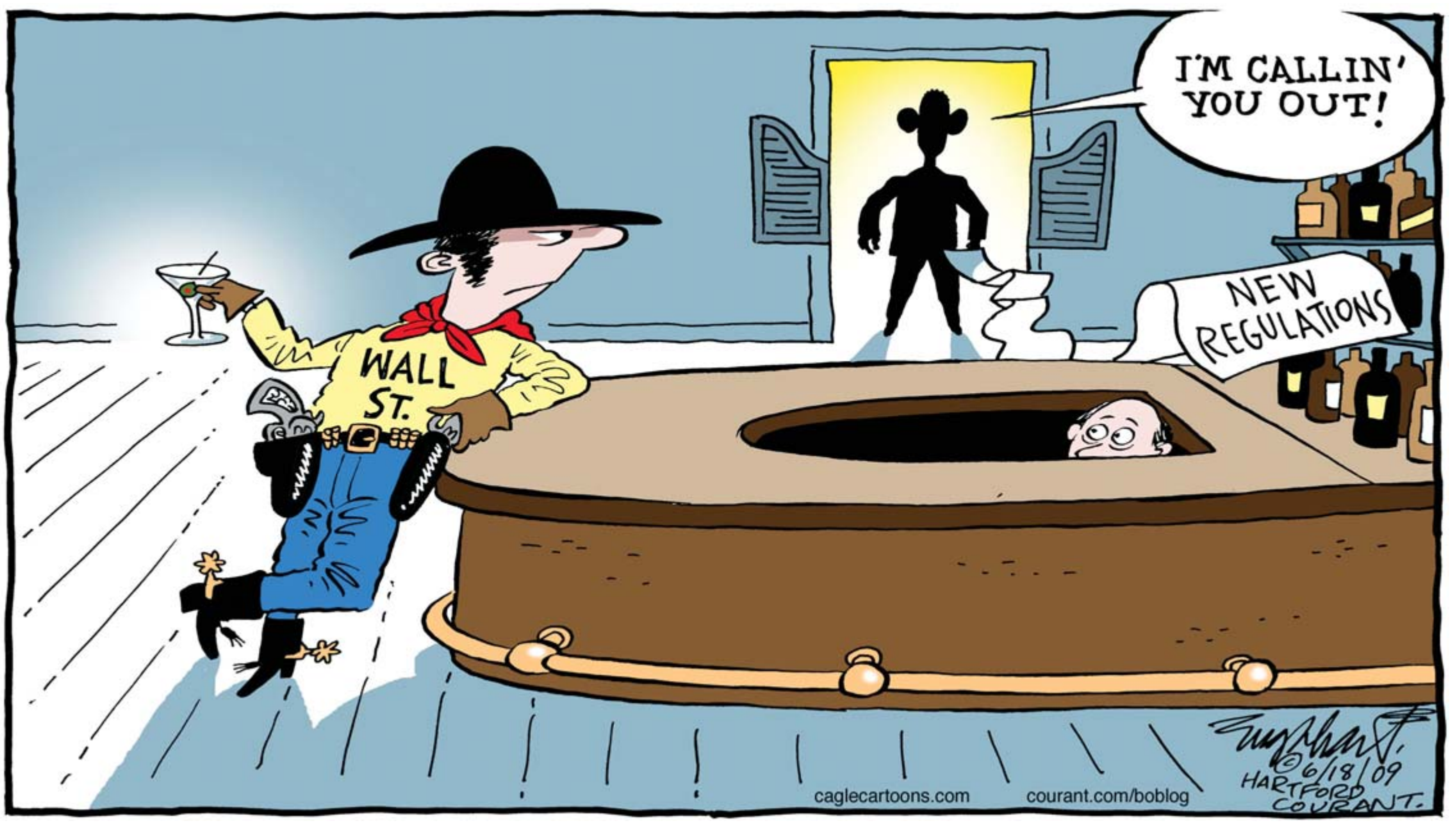

Executive Compensation Reform: The Fed to Have Its Say on Pay

By Karine Louis

The Federal Reserve has recently proposed new regulations that would allow it to veto compensation policies that encourage bank employees to take too much risk. The Fed's proposal would, for the first time, inject government regulators deep into the compensation decisions traditionally reserved for banks' corporate boards and executives.

A new front has opened in the battle to rein in excessive compensation at the nation's banks. Cognizant that compensation plans which reward bankers for pushing into high-risk areas of business for short-term gains are a cause of the current financial crisis, the Federal Reserve has recently proposed new regulations that would allow it to veto compensation policies that encourage bank employees to take too much risk. Federal Reserve officials believe such a measure would come within their existing regulatory authority over the banking system, without the need for Congressional action.

The Fed's proposal would, for the first time, inject government regulators deep into the compensation decisions traditionally reserved for banks' corporate boards and executives. While the Fed would not be able to set the pay for any of the tens of thousands of bank employees from the nation's twenty-five largest banks, it would have the power to review, and if necessary, amend each bank's salary and bonus policies to make sure they don't create harmful incentives. The proposed regulations will likely push banks to use "claw backs," or provisions to reclaim the pay of employees who take excessive risks that ultimately prove to hurt the firm. The Fed could also demand that more compensation be offered through restricted stock or other forms of long-term compensation designed to avoid rewarding short-term gains.

Although the Fed's proposed regulations mark its first entry into the fray over executive compensation, excessive compensation has continually been a hot-button issue during economic downturns. Indeed, as the economic downturn was emerging during the last Presidential Campaign, Barack Obama trumpeted the need for shareholder input on executive compensation. Calling for passage of the "say on pay" legislation he introduced in the Senate in 2007, Obama stated "This [legislation] isn't just about expressing outrage, it's about changing a system where bad behavior is rewarded so that we can hold CEOs accountable and make sure they're acting in a way that's good for their company, good for our economy, and good for America, not just good for themselves." Obama's "say on pay" legislation would have, among other things, required a non-binding annual shareholder vote on compensation for senior executive officers of public companies. Similar measures have found success in Britain, where a broad consensus of corporate directors, shareholders and government see "say on pay" as a "driver of corporate value, making public corporations more competitive and, by raising confidence in governance integrity, lowering risks for investors," according to Professor Stephen Davis of the Millstein Center for Corporate Governance at Yale University School of Management.

After a decisive campaign victory and with the financial crisis deepening, many expected Obama to quickly push through "say on pay" legislation similar to what he proposed in 2007. With the attention of his administration drawn to other issues, however, "say on pay" legislation was initially placed on the back-burner — at least until news broke that the ailing banks were using government bail-out funds received under the Troubled Asset Relief Program ("TARP") to dole out billions in bonuses.

According to data released by New York Attorney General Andrew Cuomo in July 2009, nine of the larger banks that received government aid money paid out bonuses of nearly $33 billion in 2008. In fact, six of the nine banks paid out more in bonuses than they received in profits.

In response, on February 5, 2009, the Senate approved changes to TARP that prohibited firms receiving TARP funds from paying bonuses to their 25 highest-paid employees. At about the same time, the White House and Treasury announced rules capping cash executive compensation at $500,000 for firms receiving "extraordinary help" from the government, and requiring additional compensation to be paid in restricted stock that cannot be paid until after the government loans are repaid. In addition, in February 2009, Congress enacted the American Recovery and Reinvestment Act of 2009 ("ARRA"), as part of which bonuses at banks receiving federal bailout funds were capped at no more than one-third of an employee's total compensation.

Although these compensation limits were initially well received, there was a public uproar in March 2009, after bail-out poster-child AIG awarded over $165 million in bonuses to its Financial Products unit. These payments were legally permissible because ARRA did not apply to bonuses signed before the bill was passed. The uproar intensified considerably after banking giant Citigroup — which received over $45 billion in government bail-out funds — revealed that it was contractually bound to pay an individual bonus of $100 million to commodities trader Andrew Hall. Citigroup CEO Vikram Pandit has since conceded that this is "too much money" for one employee given the level of government support the bank received.

While Hall's $100 million bonus became a lightning rod for the excessive compensation cause, the greater concern is that companies have failed to change their compensation practices and continue to issue outsized bonuses even as they are losing money. According to data released by New York Attorney General Andrew Cuomo in July 2009, nine of the larger banks that received

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Quarterly Quote...

"There is little justification for the payment of outsized discretionary compensations when a financial institution lost money for the year...we expect our shareholders to hold us to account on how we carry through these principles."

Lloyd Blankfein, Chairman, CEO of Goldman Sachs in *The Wall Street Journal* on September 9, 2009

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Eye on the Issues

LEGISLATIVE/REGULATORY UPDATES AND RECENT DECISIONS OF INTEREST

By Katherine Sinderson

New York AG Investigation Further Complicates the SEC's Bank of America Settlement

On August 5, 2009, the SEC simultaneously announced a lawsuit against Bank of America for failing to disclose large executive bonuses that the company had agreed to in its merger with Merrill Lynch and a settlement with the company of the suit. On September 14, U.S. District Court Judge Jed Rakoff emphatically rejected Bank of America's proposed settlement with the SEC as "inadequate" to redress the wrongs alleged by the SEC in its complaint. (See "The "New" SEC Comes Out Swinging" on page 8 for more detail). In response to the SEC's explanation that the company had attributed the disclosure decision to advice by counsel, Judge Rakoff questioned why the lawyers who provided advice to the company were not named in the suit. Similarly, New York Attorney General Cuomo, who is conducting an investigation of Bank of America's disclosures that is parallel to the SEC's, requested that the company reconsider its reliance on the attorney-client privilege that prevented the Attorney General from reviewing many important privileged documents. On October 12, 2009, Bank of America wrote to inform Attorney General Cuomo's office that the company had reconsidered its reliance on the attorney-client privilege and would produce many documents related to the advice provided by its attorneys. In addition, the company agreed to produce those same documents to the SEC for use in that suit. While Attorney General Cuomo has not yet made charging decisions in his investigation, the trial in the SEC action is scheduled to commence on March 1, 2010. *http://www.oag.state.ny.us/media_center/2009/oct/oct13a_09.html*

SEC Inspector General Reports on Madoff

On September 29, 2009, the SEC's Inspector General, H. David Kotz, released his most recent report related to the massive fraud committed by Bernard Madoff and the handling of the Madoff investigation. The report, entitled "Program Improvements Needed Within the SEC's Division of Enforcement," details findings from an extensive survey among SEC enforcement staff regarding necessary improvements to how they handle investigations and offers 21 recommendations for improved enforcement. The Inspector General found that the SEC's enforcement staff lacked training, guidance, and experience in reviewing complaints of highly specialized frauds like the Madoff Ponzi scheme. Recommendations included ensuring that enforcement staff receive training in evaluating complaints; that the appropriate staff is consulted on different types of complaints; and that tips from the public are completely reviewed. The new SEC Director of Enforcement Robert Khuzami has stated his agreement with the Inspector General's recommendations and has already begun to implement many of them. *http://www.sec-oig.gov/Reports/AuditsInspections/2009/467.pdf*

Fortune 100 Corporations Recommend Changes To Pay Practices

Recognizing that "[e]xecutive compensation has become a flashpoint for…frustration and anger" following the recent economic crisis, a number of "blue chip" corporations comprising the Conference Board business research group have issued a report recommending voluntary changes to corporate pay practices. According to the group, the recommendations are intended to "restore credibility and increase trust in pay practices and oversight." Specifically, the report recommends that corporations tie a "significant portion" of incentive compensation to long-term corporate goals and avoid "controversial pay practices," such as golden parachutes and "golden coffins" (posthumous executive benefits that can reach hundreds of millions of dollars). The report also contains a number of recommendations to increase independent oversight over executive compensation, including independent director and shareholder oversight, and increased disclosure of compensation practices. In addition, the report recommends that all compensation programs be "transparent and easily understood by investors," and that corporations should ensure that an "advisory vote on executive pay is effectively implemented and facilitates dialogue between shareholders and boards regarding executive compensation." Members of the Conference Board and signatories to the report include representatives from several Fortune 100 corporations, corporate governance experts, and large institutional investors. *http://www.conference-board.org/pdf_free/ExecCompensation2009.pdf*

Moody's In The Hot Seat

The House of Representatives Committee on Oversight and Government Reform recently reconvened a hearing to examine the role of credit ratings agencies in the financial crisis, and to determine what regulatory steps could be implemented to avoid future catastrophe. At the September 30, 2009 hearing, whistleblower and former Moody's Investors Service managing director Erik Kolchinsky informed the Committee that issues of bias and lack of independence still plague the ratings agencies. Mr. Kolchinsky stated that "[i]n many ways the incentives for rating agencies have become worse since the credit crisis," given the heightened competition among the ratings agencies for "significantly fewer transaction dollars." In a letter provided to the Committee, Kolchinsky informed the SEC that Moody's had knowingly violated the securities laws by providing "incorrect" ratings. Similarly, in a letter to the SEC, former Moody's Corp. head of Compliance Scott McCleskey reported on Moody's ongoing failures of compliance, "of which senior management at Moody's is well aware…but is unwilling to make more than a token effort" in response. Moody's chief credit officer, Richard Cantor, responded that Mr. Kolchinsy's claims are "unsupported" and that an investigation by an outside law firm had confirmed Moody's compliance. *Documents provided by the Committee are available at http://oversight.house.gov/story.asp?ID=2615.*

Ratings Agencies Not Protected By First Amendment In Subprime Fraud Suit

In early September, the United States District Court for the Southern District of New York denied a motion to dismiss filed by Moody's Corp. and Standard & Poor's in a fraud suit based on their ratings of subprime-linked securities. The court observed that," although a rating agency's role as an unbiased reporter of information typically requires the rating agency to remain independent of the issuers for which it rates notes, the [defendant rating agencies] played a more integral role in the structuring and issuing of" the securities at issue. The rating agencies received fees based upon the value of the rated assets, which, in turn, was directly related to the rating those assets received from the rating agencies. The court noted that generally ratings agencies are afforded First Amendment protection for their ratings, as their ratings are considered a matter of public concern. However, in this case, where the ratings agency had disseminated its ratings to a select group of investors, First Amendment protection was not available. *Abu Dhabi Commercial Bank v. Morgan Stanley & Co. Inc. et al., 1:08-cv-07508-SAS (S.D.N.Y.)*

Proactive Shareholders Vote Against Directors To Voice Governance Concerns

During the 2009 proxy season, there was a significant increase in shareholder votes against incumbent directors than in previous proxy seasons. Data collected by advisory firm Proxy Governance shows that 9.8 percent of unopposed director nominees had at least 20 percent of shares voted against them or withheld — up from 5.5 percent in 2008. The firm attributed the increase in shareholder dissatisfaction to heightened governance concerns, including anger at directors for "ignoring a majority vote on a shareholder proposal [or] adopting or renewing a poison pill without shareholder approval," while recognizing that plummeting share prices and the economic crisis also contributed. The study also noted that opposition is likely to increase in 2010 as regulatory changes will limit broker discretionary voting (voting by brokers who have not received instructions from their shareholders) and increase shareholder proxy access. *A summary of the data gathered can be found at http://blogs.law.harvard.edu/corpgov/2009/09/29/sharp-increase-in-shareholder-votes-opposing-director-nominees/.*

The SEC's New Division of Risk, Strategy, and Financial Innovation

The Securities and Exchange Commission has created a new division aimed at identifying developing risks and trends in the financial markets. The new Division of Risk, Strategy, and Financial Innovation will combine the Office of Economic Analysis and the Office of Risk Assessment and other functions to provide the Commission with "sophisticated analysis that integrates economic, financial, and legal disciplines," according to the SEC press release. The division's responsibilities cover three general areas: risk and economic analysis; strategic research; and financial innovation. It will perform all of the functions previously performed by the two offices, as well as strategic and long-term analysis; identifying new developments and trends in financial markets and systemic risk; making recommendations as to how these new developments and trends affect the Commission's regulatory activities; and conducting research and analysis and providing training on new developments and trends. According to some commentators, this is the first new division created by the SEC since 1971. *http://www.sec.gov/news/press/2009/2009-199.htm*

Congress Considering Investor Protection Legislation

On October 1, Pennsylvania Congressman Paul E. Kanjorski, the Chairman of the House Financial Services Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises, released "discussion drafts" of three pieces of proposed legislation that are "aimed at tackling key parts of reforming the regulatory structure of the U.S. financial services industry." The draft bills are termed the Investor Protection Act, the Private Fund Investment Advisers Registration Act, and the Federal Insurance Office Act. Among other things, the Investor Protection Act would, according to the press release, double the SEC's funding over five years and provide "whistleblower bounties" to encourage insiders to report wrongdoing. The Private Fund Investment Advisors Act would require many financial providers, such as hedge funds, to register with the SEC. The proposed provisions specify recordkeeping and disclosure requirements and allow regulators to, as the press release states, "examine the records of these previously secretive investment advisors." The Federal Insurance Office Act would provide regulators" with access to the information and resources needed to respond to crises, mitigate systemic risks, and help ensure a well functioning financial system." *http://kanjorski.house.gov/index.php?option=com_content&task=view&id=1627&Itemid=114*

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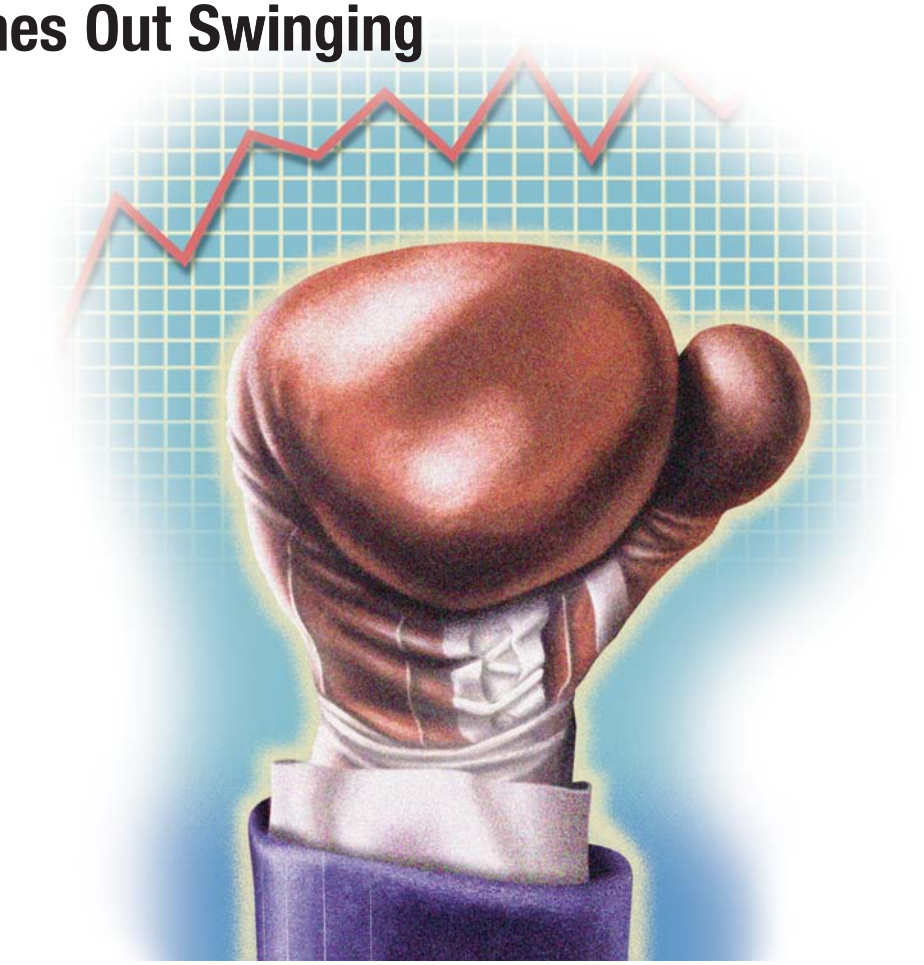
The "New"SEC Comes Out Swinging

by Adam Wierzbowski



Over the past few years, the SEC has been criticized for failing in its central mission to protect investors. The SEC has admitted that it failed in its oversight of collapsed investment bank Bear Stearns, missed opportunities (despite early warnings) to stop the massive Ponzi schemes of Bernie Madoff and Allen Stanford, and, according to a Government Accountability Office report, should have earlier detected the market-timing abuses that were rampant in the mutual fund industry. These failures have resulted in investor losses in the billions, and led to calls for regulatory reform. As Representative Carolyn Maloney stated earlier this year "Many of us have lost confidence in the SEC."

SEC Chair Mary Schapiro and new enforcement director Robert Khuzami are now trying to restore the SEC's tarnished reputation. During a four-day stretch this past August, the SEC began the long road back towards reestablishing itself as a staunch protector of investor rights by announcing high-profile enforcement actions and settlements against Bank of America, General Electric, and former AIG executives, including former Chairman and CEO Hank Greenberg. According to Mr. Khuzami, these efforts were intended to establish a "sense of urgency" to the agency's work and further the SEC's message of "prompt accountability."

In August, the SEC began the long road back towards reestablishing itself as a staunch protector of investor rights by announcing high-profile enforcement actions and settlements against Bank of America, General Electric, and former AIG executives.

The SEC effort started in earnest on August 3, 2009, when it brought suit against Bank of America, charging that the company had violated proxy disclosure rules in connection with its $50 billion acquisition of Merrill Lynch. Specifically, the SEC charged that Bank of America falsely represented to investors that Merrill Lynch had agreed not to pay year-end performance bonuses before the deal closed without Bank of America's consent, when in fact Bank of America had already secretly agreed to allow Merrill to pay billions of dollars in bonuses to Merrill Lynch employees prior to the deal close without regard to Merrill's financial performance. Investors were outraged to learn in January 2009 that Merrill had paid out $3.6 billion in pre-close bonuses, even as it lost more than $15 billion in the fourth quarter of 2008 alone and more than $27 billion for the year. The same day that it filed suit, the SEC announced that it had agreed to settle these charges for $33 million.

The next day, on August 4, 2009, the SEC announced that General Electric had agreed to pay a $50 million fine to settle charges that its 2002 and 2003 financial statements were misleading. The settlement ended a longstanding probe into General Electric's accounting procedures, including financial hedges and revenue recognition, which the company used to improperly boost earnings or avoid disappointing investors. Two days later, on August 6, 2009, the SEC announced a settlement with two former AIG executives, including a

$15 million payment from past AIG Chairman and CEO Hank Greenberg. In a complaint filed that same day, the SEC alleged that under Mr. Greenberg's leadership, AIG improperly accounted for "a number of financial challenges" that would have exposed significant missteps in AIG's operations and caused the company to miss certain key earnings and growth targets, had they been properly reported. The settlement ended the SEC's four and half year investigation into whether Mr. Greenberg and another former AIG executive, Howard Smith, were aware of AIG's improper accounting.

These settlements coincided with the SEC's August 5, 2009 announcement of the biggest overhaul of its enforcement division in three decades. The enforcement division will be restructured to have more front-line investigators, fewer management layers and at least five specialist units focused on expanding areas of the market. In addition, an Office of Market Intelligence will be created to collect analysis, tips, and referrals the agency receives, to be processed and used in a centralized manner. SEC supervisors will now also have the authority to initiate formal orders of investigation and issue subpoenas directly, without having to first gain the approval of the five-member commission. As Mr. Khuzami explained, "These senior officers are on the scene and closest to the facts. Granting them the autonomy to make routine case decisions should expedite our investigative process."

While these initiatives have generally been well received by investors, the SEC has found itself on the defensive again for its attempted settlement of the Bank of America matter. U.S. District Court Judge Jed Rakoff recently rejected the proposed settlement in a strongly-worded opinion that called the agreement "a contrivance designed to provide the SEC with the façade of enforcement and the management of [Bank of America] with a quick resolution of an embarrassing inquiry — all at the expense of the sole alleged victims, the shareholders."

Quarterly Quote...

"Overall, indeed, the parties' submissions, when carefully read, leave the distinct impression that the proposed Consent Judgment was a contrivance designed to provide the S.E.C. with the façade of enforcement and the management of the Bank with a quick resolution of an embarrassing inquiry — all at the expense of the sole alleged victims, the shareholders."

The Honorable Jed Rakoff of the U.S.Dist.Ct., Southern District of New York in a September 14, 2009 opinion rejecting a proposed $33 million settlement between the SEC and Bank of America of allegations that Bank of America misled its shareholders in connection with its acquisition of Merrill Lynch

The SEC announced the biggest overhaul of its enforcement division in three decades. The division will be restructured to have more front-line investigators, fewer management layers and at least five specialist units focused on expanding areas of the market. In addition, an Office of Market Intelligence will be created to collect analysis, tips, and referrals the agency receives, to be processed and used in a centralized manner.

Judge Rakoff was upset by the SEC's failure to name any individuals as defendants, in contravention to its own policy, the SEC's failure to rigorously test Bank of America's defenses, and the fact that the fine would ultimately be paid by the very shareholders who were victimized by the company's materially false and misleading proxy materials. Judge Rakoff commented that the proposed settlement suggested "a rather cynical relationship between the parties: the SEC gets to claim that it is exposing wrongdoing on the part of the Bank of America in a high-profile merger; [Bank of America's] management gets to claim that they have been coerced into an onerous settlement by overzealous regulators. And all this is done at the expense, not only of the shareholders, but also of the truth."

It remains to be seen what impact, if any, Judge Rakoff's decision will have both on SEC settlement practices and

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INVESTOR PROTECTIONS

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With the litigation resources of the executive branch and administrative agencies stretched thin, Senator Specter recognizes that the enforcement of the federal securities laws that benefit the public "will fall increasingly to private litigants." In light of the strong public sentiment that harmed investors must be able to hold accountable secondary actors, such as auditors, investment banks, lawyers, and rating agencies, the proposed legislation may have its best shot at passage in years.

Other Legislative Measures To Enhance Private Securities Litigation

The Aiding and Abetting Act is just one legislative effort to overturn judicial obstacles to harmed investors' ability to bring suit for recovery. Senator Specter has also introduced legislation to overturn two other Supreme Court decisions that have substantially raised the pleading burden that a plaintiff's complaint must meet to survive a motion to dismiss. The "Notice Pleading Restoration Act" would overturn the Supreme Court decisions in *Bell Atlantic Corp. v. Twombly* (2007) and *Ashcroft v. Iqbal* (2009), which require a plaintiff to include in their initial pleadings substantial factual assertions that give "facial plausibility" to their claims. The *Twombly* and *Iqbal* decisions represent a major shift from earlier precedent that required plaintiffs to plead only a simple statement of the case against the defendant. Well-regarded legal scholar and long time civil procedure expert, New York University Law professor Arthur Miller said in regards to *Twombly* and *Iqbal*, "I have spent my whole life with the federal rules, and this is one of the biggest deals I have ever seen….I see serious problems with democratic values here, with access to the courts, with resolution of disputes with a jury of peers." Although neither *Twombly* nor *Iqbal* specifically addressed securities actions, defendants in securities actions have repeatedly sought to use the decisions to argue for further heightened pleading standards for investors.

The legislative efforts of Senator Specter and Senator Reed plainly recognize emerging investor sentiment that harmed investors should be able to hold accountable all those who commit or contribute to fraudulent conduct.

In addition, Rhode Island Senator Jack Reed, who co-sponsored the Aiding and Abetting Act, is also sponsoring the Rating Accountability and Transparency Enhancement Act (the "RATE Act"). Responding to the public outrage over the prominent role that rating agencies have played in the recent subprime crisis, and the increasing evidence that their ratings were heavily influenced by the issuers who were paying their fees, the RATE Act would create a private right of action against rating agencies that failed to conduct a reasonable investigation of a rated security. This would be an important measure for investors as rating agencies, thus far, have largely been able to avoid liability for issuing false and misleading ratings by asserting that those ratings were mere opinions, protected as free speech under the First Amendment.

The legislative efforts of Senator Specter and Senator Reed plainly recognize emerging investor sentiment that harmed investors should be able to hold accountable all those who commit or contribute to fraudulent conduct. Although it may be too late to hold accountable all those who contributed to the current turmoil in our financial system, the measures introduced would enable investors to play a critical role in policing the conduct of secondary actors through private actions to ensure that future fraudulent conduct does not go unpunished.

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NEW SEC

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the way courts view SEC settlements. Negotiated settlements are the SEC's biggest tool for regulating financial markets and protecting investors. An estimated 90% of all SEC investigations are resolved through settlements, typically with the defendants agreeing to pay a fine and/or enact remedial changes without admitting or denying wrongdoing. Through such settlements, the SEC attempts to send a message of deterrence and "fix the problem" without straining its limited enforcement budget resources on costly trials.

With Judge Rakoff casting an unflattering light on how the SEC hammered out a deal with Bank of America and allowed the individuals actually responsible for the alleged conduct to escape liability, there is debate whether judges will begin to ask tougher questions of the SEC before approving settlements of SEC enforcement actions. Further, some wonder if the SEC will feel the need to more frequently name responsible individuals as defendants. Whether the "new" SEC is able to reclaim its reputation as the watchdog for investors may hang in the balance.

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SAY ON PAY

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government aid money paid out bonuses of nearly $33 billion in 2008. In fact, six of the nine banks paid out more in bonuses than they received in profits.

In response to public sentiment, President Obama appointed a Special Master for Compensation, or "Pay Czar," with broad authority to oversee the compensation of senior executives and the top-100 earners at the seven companies that received "exceptional assistance" from TARP: AIG, Bank of America, Citigroup, General Motors, GMAC, Chrysler and Chrysler Financial. The Pay Czar is tasked with reviewing compensation to make sure that it is neither excessive nor oriented to short-term risk taking. The current Pay Czar, Kenneth Feinberg, is expected to issue a ruling on Mr. Hall's bonus by the end of October 2009.

In addition to appointing the Pay Czar, the Obama administration issued support for legislation intended to overhaul executive pay practices. Beyond requiring that compensation consultants and legal counsel be hired by an independent committee and not management, the proposed legislation would require federal regulators to enact rules regarding compensation structures in the financial sector. Missing from the bill, however, are any hard limits or caps on executive compensation. Instead, the goal is to limit incentives to take excessive risk at the expense of long-term health in order to reap short-term rewards. As proposed, the Fed regulations would provide additional means to further that goal.

The Fed's proposal is not yet finalized and will still require an affirmative vote by the Fed's Board. Moreover, the Fed might face a challenge from Congress over its authority to enact the proposed regulations, which could prevent or delay implementation of the measures. Regardless of whether the Fed is able to successfully enact its proposal, it has become clear to the banks at the heart of the financial crisis that executive compensation reform is necessary and forthcoming. One need not look further than Goldman Sachs CEO Lloyd Blankfein to illustrate the point.

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In April 2008, Mr. Blankfein argued that a non-binding shareholder vote on executive compensation, as proposed under then-Senator Obama's "say on pay" legislation, "would create a cloud, a constraint, a limitation on decisions that have been at the heart of what a board has done." Seventeen months later, in September 2009, after watching many of his rivals crumble as a result of excessive risk and short-term incentives, Mr. Blankfein has called investor anger over bank compensation schemes and bonuses "understandable and appropriate." Advocating a ban on multi-year, guaranteed employment contracts, Mr. Blankfein remarked, "There is little justification for the payment of outsized discretionary compensation when a financial institution lost money for the year. In April, our firm made public a set of detailed principles of compensation…We expect our shareholders to hold us to account on how we carry through these principles."

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