



# SECURITIES REGULATION & LAW



## REPORT

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### SEC ENFORCEMENT

## Denver Lawyer Sees Fairness Issues in SEC's Expanded Use of Emergency Orders

The Securities and Exchange Commission's expanded use of temporary restraining orders and other ex parte relief effectively is preventing securities fraud defendants from seeking the advice of counsel, raising serious "fairness questions," Denver lawyer Michael MacPhail, Holme, Roberts & Owen LLP, told BNA Aug. 18.

In a telephone interview, MacPhail acknowledged that there is no recognized right to an attorney in a civil action. However, he emphasized, "the legal system in this country is based on both sides' being able to advocate their position." The SEC's procedure "makes that very difficult and even precludes one side of the dispute from telling its story."

**New Policy.** As SEC Enforcement Director Robert Khuzami recently acknowledged, the period from late January to the date of his Aug. 5 address saw a 147 percent increase in TROs as compared with roughly the same period in 2008 (41 SRLR 1473, 8/10/09).

In large part, Khuzami stated, the ramped up enforcement effort was prompted by fallout from his agency's failure to uncover Bernard Madoff's Ponzi scheme before it was revealed late last year by the former Nasdaq chairman himself—a major embarrassment for the commission. A number of critics suggested that the SEC was looking the other way in the face of ongoing fraud and questioned its ability to fulfill its investor protection mandate. In one of her first priorities, incoming Chairman Mary Schapiro pledged to "reinvigorate" enforcement at the beleaguered agency.

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MacPhail, however, questioned whether the spike in emergency ex parte actions "is truly representative of a spike in ongoing fraudulent activity." Rather, he posited, "what's driving it is a new policy, perhaps unarticulated," to be "tougher in a number of areas," including more aggressive use of emergency relief.

MacPhail agreed that the Madoff debacle raised legitimate concerns about the efficacy of the SEC enforcement program. While the commission gets more tips than it can possibly investigate, he stated, "the system failed in the Madoff case, and the SEC was part of the systemic failure."

"It's fine for the commission to be tougher." The public has a right to expect that, MacPhail acknowledged. "This, though, is an example of going maybe too far in the frequency of these orders that are being sought and obtained."

He also agreed that seeking emergency relief to halt an ongoing securities scam "is an extremely effective means of protecting the public. That's obviously the rationale."

However, he said he is concerned that the commission is using its emergency powers too frequently, and is "refusing to compromise in the type of orders it is



seeking and entering.” According to MacPhail, the agency should be pursuing a “potential middle ground” that would protect investors and also provide some limited relief to those accused of securities fraud, who are precluded from hiring lawyers in cases that could have criminal implications.

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should entertain “reasonable and limited  
carve-outs for defendants to pay living expenses  
and attorneys’ fees.”**

One such securities fraud defendant, according to MacPhail, is Texas businessman Robert Allen Stanford, who along with his “complex web of companies” was sued by the agency over his alleged operation of a multi-billion dollar scheme involving misleading sales of certificates of deposit and a proprietary mutual fund wrap program (41 SRLR 289, 2/23/09). To halt what the SEC described as a “massive, ongoing fraud,” the district court granted an emergency order, freezing the defendants’ assets and appointing a receiver.

The lawsuit against Stanford, according to MacPhail, is second only to the Madoff controversy in terms of important cases the SEC has brought related to the economic crisis. However, he contended, “Stanford’s criminal defense attorney no longer wants to represent him because he has no assurance that Stanford will be able to pay him, and his new counsel hasn’t filed a motion to substitute into the criminal case because they too want to be sure they will be paid. This deprives the public of confidence that the government’s charges are supported by the evidence and can be tested in litigation.”

Ordinarily, MacPhail posited, lawyers would be “falling all over themselves to represent people in a high profile case like this one. But Stanford doesn’t have anybody because he can’t pay them” as a result of the asset freeze. “So far the court has refused to allow his new proposed counsel into the criminal case for the limited purpose of resolving whether Stanford will be granted access to monies to pay legal fees.” Accordingly, “[w]e may never get to hear Mr. Stanford’s side of the story.”

“There’s no limited entry of appearance,” MacPhail noted. Also, “it’s difficult to get these orders lifted. The SEC nearly always opposes” a motion to modify a freeze order, he said, and “private practice is not pro-bono based,” especially for large, complicated lawsuits. “These are not traffic ticket cases.”

**Compromise.** MacPhail said he thinks the commission “should be amenable to compromise in the scope of asset freeze orders,” and in appropriate cases should en-

**Enforcement Statistics.**

Khuzami reported that comparing the period from late January through July to roughly the same period in 2008, the Enforcement Division has:

- opened 10 percent more investigations (approximately 525, compared to 475);
- been granted 118 percent more formal orders (275, compared to 126);
- filed 147 percent more TROs (52, compared to 21); and
- filed nearly 30 percent more actions (397, compared to 306).

tain “reasonable and limited carve-outs for defendants to pay living expenses and attorneys’ fees.” The commission also should consider limiting the scope of the freeze to assets that are traceable to the alleged misconduct, MacPhail added. The current practice, however, is to seek blanket freeze orders that prevent defendants from even borrowing from a bank to pay their attorneys, he contended.

“The SEC takes the position, and would oppose motions in court to use borrowed money for paying expenses and attorneys fees.” The commission “takes a very hard line on this issue and is very reluctant to grant any relief from these freeze orders,” MacPhail stated; borrowing from family members is even in question. “The very broad nature of these orders makes it impossible to spend any money for any purpose until some relief is granted.”

MacPhail acknowledged that freeze orders are orders of the court, not the SEC, so “there is that check and balance. However,” he stated, “when the government comes into court and says ‘we have evidence of an ongoing fraud,’ it has a great deal of credibility that private litigants don’t have.”

“These orders are done on an ex parte basis; there’s no notice given,” and no time in which to mount a defense. Accordingly, the court is highly likely to grant relief on the record before it, “which is all one-sided.” Most of the time, emergency orders are signed “just the way they’re written by the government,” MacPhail amplified. “It’s an exception to the rule that they’re narrowed.”

But aren’t emergency orders of very limited duration? They are, MacPhail acknowledged. However, he told BNA, such orders frequently are converted to preliminary injunctions—a move a defendant without representation essentially is unable to oppose. “Once a preliminary injunction is entered, it is ‘game over’ for these defendants because the freeze is in effect until the litigation is over, which means default or settlement on the government’s terms.”

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**New Powers.** However, MacPhail took a different view of a number of other recently announced enforcement initiatives.

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In his Aug. 5 address, Khuzami also reported the commission’s delegation to the division director the au-

thority to issue formal orders of investigation, with accompanying subpoena power. “I’m supportive of this one,” MacPhail stated, commenting that when he was a staff member, it was “excessively difficult to get subpoena authority.”

While much depends on how the new authority is applied, he said he thinks that there are appropriate systems in place to prevent abuse. Commenting that subpoena power in the staff’s hands “tends to speed up the investigation,” MacPhail added that so far, he is “not convinced that it’s a bad idea to delegate this particular responsibility to the staff, and also to negotiate settlements. I think this is another area where the commission was unduly interfering with the staff’s ability to settle big cases. It’s the new return of the old procedure. I think that’s appropriate.”

BY PHYLLIS DIAMOND