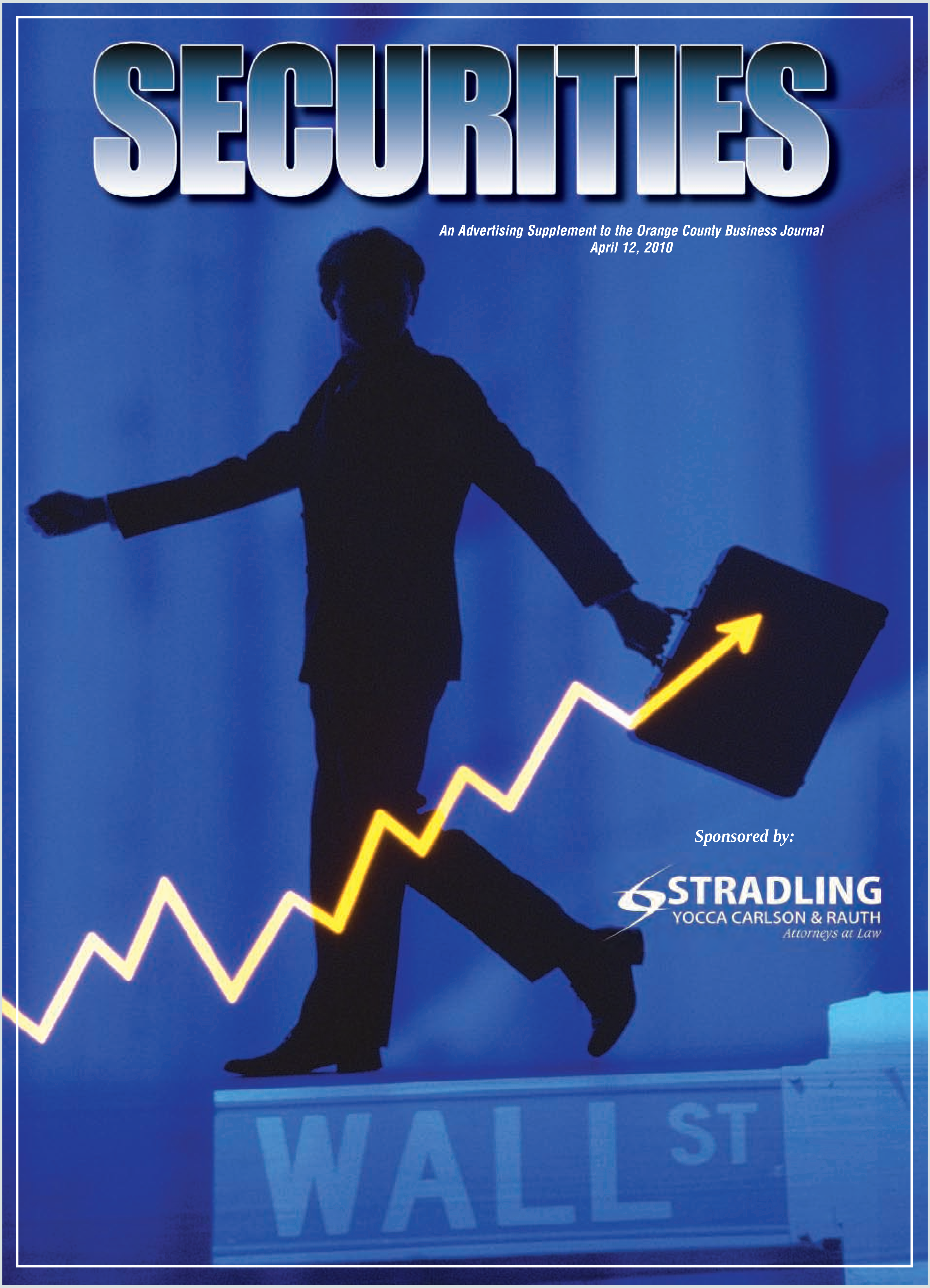
SECURITIES

An Advertising Supplement to the Orange County Business Journal
April 12, 2010



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SEC Rearms and Retools Itself

by Kathleen Marcus, Counsel, Stradling Yocca Carlson & Rauth

Eighteen months ago, media reports concerning the Securities and Exchange Commission's failure to uncover or prevent the Madoff Ponzi scheme put the agency on the defensive. Finding itself openly flogged by a finger-pointing Congress and the national media, the SEC needed a makeover, fast.

To create its new image, the SEC borrowed a playbook from the Department of Justice. Led by Robert Khuzami, an eleven-year veteran prosecutor with the DOJ, the SEC's Enforcement Division is getting an infusion of new life: the White House has proposed an 11% budget increase for 2011 ($1.258 billion), a technological overhaul, the addition of more investigating attorneys and trial lawyers, specialization units, cooperation credits and deferred prosecution agreements, an expanded bounty program to entice whistleblowers, and streamlined ties to the DOJ for joint investigations.

As the SEC strives to change and restore public perception, public companies and market players must reassess their policies, procedures, risk tolerance and strategies in light of the more criminal-like toolkit of their regulator.

New Enforcement Initiatives

In a widely publicized announcement in August 2009, Director Khuzami announced five new initiatives to overhaul the Enforcement Division, including: (1) the formation of specialization units; (2) the streamlining of management and internal processes; (3) the creation of an Office of Market Intelligence; (4) the fostering of cooperation by individuals; and (5) a commitment to the strategic use of new resources. Several of the new initiatives are poised to have a significant impact.

■ ***Specialization Units***

While still under formation, the Enforcement Division's new specialization units seek to create teams with expertise in particularly complex areas, supervised by leaders in various SEC offices. Modeled after the units of a federal prosecutor's office, the SEC designed its specialization units to silence Madoff-induced criticisms that the staff is "financially illiterate." A material percentage of the Enforcement staff will be assigned to the new units, which include:

• **Asset Management –** the largest unit tasked with overseeing investment advisors and companies, hedge funds, mutual funds and private equity funds.

• **Market Abuse –** charged with policing large-scale market abuses and complex manipulation schemes, such as organized insider trading rings and large cap market manipulations, front running, collusive trading, abusive short selling, and institutional regulatory and internal control violations, with a key objective of developing and deploying automated trading data analysis.

• **Structured and New Products Unit –** focused on securities violations involving complex derivatives and financial products, such as credit default swaps, collateralized debt and securitized products.

• **FCPA –** charged with revamping cases under the FCPA, which prohibits bribing foreign officials to obtain contracts and business, by conducting targeted sweeps and sector-wide investigations with counterparts in the U.S. and abroad.

• **Municipal Securities and Public Pensions –** tasked with investigating offering and disclosure issues, tax and arbitrage activity, unfunded or under-funded liabilities, pay-to-play schemes and kickbacks in this arena.

The success of the specialization units will largely depend on effective management and staff retention. However, the geographic diversification of the unit heads may have the added benefit of softening intra-agency squabbles, which have been common-place among SEC offices and may have been partially responsible for the SEC's failure to uncover the Madoff scheme.

■ ***Enticing Whistleblowers***

The SEC hopes to leverage its resources by motivating whistleblowers to come forward, thereby chilling violators by increasing their fear of being reported by insiders. The SEC is flashing both a carrot and a stick to encourage whistleblowers to come forward, with enticements ranging from an overhaul of the SEC's bounty program to deferred or non-prosecution agreements and providing guidance on cooperation credit.

The SEC has begun the process of brushing off and expanding its two-decade-old and underutilized bounty program for whistleblowers. SEC Inspector General David Kotz released a report dated March 29, 2010 making numerous recommendations about how to improve the bounty program. Likely changes include a strategy to inform the public about the bounty program and making the application process more user-friendly. In addition, as part of its makeover in the image of a prosecutor's office, the SEC is adopting the practices of the DOJ and the Internal Revenue Service regarding application for bounties, analysis of whistleblower information and tracking of tips. The SEC has also asked Congress to expand the SEC's authority to pay bounties for information related to any case that leads to an enforcement action with penalties exceeding $1 million. Historically, payment of bounties were limited to insider trading matters. *See* 18 USC §78u-1(e). Remarkably, the SEC's current bounty program has only paid out a total of $159,573 to five claimants in its twenty-year history.

■ ***Fostering Cooperation and Self-Reporting***

Additionally, the SEC is pursuing new avenues to encourage cooperation and self-reporting by offering deferred or non-prosecution agreements and providing details on cooperation credit. For those companies and individuals who find themselves in the crosshairs of the SEC and the DOJ, the new cooperation initiatives can provide some shelter if appropriate actions are taken rapidly and strategically. For example, similar to incentives offered by criminal prosecutors, the SEC's new initiatives reward companies and individuals who come forward quickly, provide needed information and preserve agency resources.

For corporations, the factors for obtaining company cooperation "credit" remain substantially unchanged, relying on the considerations set forth in the 2001 "Seaboard Report." In summary, corporate cooperation factors include: 1) the company's self-policing practices prior to the investigation (including the effectiveness of company policies and procedures and overall "tone at the top"); (2) self-reporting of misconduct; (3) remedial measures by the company, including discipline for wrongdoing, modifying internal controls and compensating victims; and (4) cooperating with law enforcement, including providing the staff with all information relevant to the underlying violations and the company's remediation efforts.

Determining the most effective methodology for seeking cooperation credit under Seaboard requires thoughtful strategic decisions, including an evaluation of the risks of self-reporting, determining when sufficient facts have been gathered to effectively and accurately self-report (balancing a quick and timely report with the effective implementation of important remedial measures); deciding whether to provide an oral or written report or give a presentation, an assessment of which documents should be produced and an analysis of the impact of a privilege waiver.

Moreover, for the first time, the SEC has articulated factors for extending cooperation credit to individuals, which encompass similar types of considerations the DOJ takes into account in its criminal matters. *See* United States Attorney's Manual 9-27.420. The considerations include:

1. The value and nature of the cooperation provided in the investigation;

(a) The SEC will apprise the *value* of the cooperation by considering whether the individual was the first to report the misconduct, the quality of the assistance and the time and resources saved by the cooperation;

(b) The SEC will apprise the *nature* of the cooperation by assessing whether the cooperation is voluntary and whether the individual encouraged others to cooperate;

2. The importance of the underlying matter;

3. The societal interest in holding the individual accountable for the misconduct, including a consideration of the severity of the individual's misconduct, the individual's toleration of the illegal activity and effort to remediate the harm caused;

4. The profile of the individual, including a history of lawfulness, the degree of accepted responsibility, and the opportunity for future violations.

See SEC Enforcement Manual, §6.1.1. Another SEC message has also surfaced: latecomers will rarely receive cooperation credit.

In addition to the articulation of the considerations for cooperation credit, the latest Enforcement Manual empowers the Enforcement Division to enter into written cooperation agreements with an individual or company wherein the staff promises to recommend to the SEC Commissioners that the individual or company receive cooperation credit for, among other things, providing substantial assistance and cooperating fully and truthfully. Although the staff's recommendations are not binding on the Commissioners, staff recommendations are strongly considered and frequently followed.

■ ***Deferred Prosecution Agreements and Joint Investigations***

In addition to outlining the use of proffer agreements, the SEC's Enforcement Manual references new prosecutorial techniques not previously available to the staff. For example, companies and individuals can also enter into deferred and non-prosecution agreements, wherein the SEC agrees to forego an enforcement action if the individual or company agrees to cooperate fully and truthfully, among other representations. *See* Enforcement Manual § 6.2.3-4. In a related effort, the Commission is streamlining its process with the DOJ for submitting witness immunity requests. *See* Enforcement Manual §6.2.5. Furthermore, while not specifically spelled out in the Enforcement Manual, recent actions brought by the SEC and the DOJ suggest that coordination between the two entities continues to strengthen. Massive sting operations in securities-related matters continue to dominate the headlines, with the DOJ using wire taps, search warrants and undercover agents to bring down sophisticated insider trading rings and systematic violations of the Foreign Corrupt Practices Act. Tactics traditionally reserved for organized crime and drug busts are now being utilized in the white collar world of joint SEC / DOJ investigations.

Smart Strategies in the New Era

Public companies, their officers and directors, and market players who have yet to find themselves sideways with the SEC or the DOJ should strongly consider taking proactive steps in this reinvigorated enforcement environment.

• Public companies should review their compliance programs and insider trading policies to ensure that the policies are up-to-date, distributed routinely, implemented consistently and well-documented. Public companies that operate internationally should seek assistance in tailoring their policies to prevent violations of the Foreign Corrupt Practices Act.

• Every public company should have a current electronic document retention program that is well-documented and effectively implemented.

• Employees should receive periodic training in legal compliance, including insider trading and document retention. Employees should also be alerted to the increased use of wire taps and undercover agents in government investigations in an effort to deter them from making poor choices.

• Companies should design and implement readiness procedures in the event their offices become the subject of a search warrant. This possibility is more likely in today's enforcement environment than at any time in the last eighty years. Having an enforcement "readiness plan" and taking proactive measures for such circumstances can mitigate against misstatements given by unprepared employees and avoid the prolonged loss of critical documents, information, technology, equipment and materials seized during a search. Preparedness also puts the company and any individual in the best position to take advantage of the new cooperation guidelines.

• When facts suggesting a potential violation of the securities laws surface, the immediate retention of outside counsel experienced in enforcement matters to conduct an internal investigation and assist in strategic considerations is imperative.

The SEC's makeover in the image of a prosecutor's office has succeeded in quieting some of the calls to extinguish the agency. Harry Markopolos, a whistleblower from the Madoff fraud and a vocal SEC critic, recently softened his blows against the Commission. Markopolos acknowledged that the SEC is getting better at policing the industry, calling the changes "evolutionary, not revolutionary." However, for the hundreds of individuals and companies feeling the power of the SEC's new tools and tactics, the SEC's rearmed and retooled Enforcement Division means uncharted terrain requiring agile and well-informed strategies.

Kathleen Marcus

Kathleen Marcus is Counsel at Stradling Yocca Carlson & Rauth, with a practice dominated by SEC Enforcement investigations, inquiries by stock exchanges, internal investigations and securities class actions. Kathleen also counsels companies on their internal controls and compliance policies. Prior to joining SYCR, Kathleen taught courses concerning SEC Enforcement at the University of Notre Dame Law School and served as Senior Counsel for the SEC's Division of Enforcement in Washington, D.C.

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California Rescission Rights for Transactions Involving Unlicensed Broker-Dealers

by George Wall, Senior Partner, Corporate Section, Rutan & Tucker LLP

California Corporation Code Section 25501.5 is a little known code section that may have major implications for merger and acquisition transactions and for early stage companies seeking initial funding. This code section became effective January 1, 2005 and provides (i) rescission rights to a buyer who purchases securities from or through an unregistered broker dealer or unlicensed intermediary who is not a mere finder or (ii) the ability to recover monetary damages if the purchaser no longer owns such securities. If the investor no longer holds the securities, such investor may sue for damages, including attorney's fees, costs and treble damages up to $10,000.

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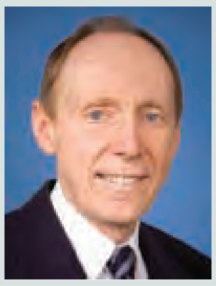

George Wall

Why is this a problem?

Early-stage companies or funds seek funding from investors frequently with the assistance of intermediaries. Similarly, intermediaries are often used in connecting a buyer and seller of a company. In the event these intermediaries are more than a finder and are not properly licensed and receive compensation, California Corporation Code Section 25501.5 can trigger a rescission right or a claim for damages. Repeatedly, we have seen transactions involving individuals or entities seeking to receive fees that are not finders and are unregistered broker-dealers.

What is a finder?

A non-statutory exemption from the licensing requirements exists for individuals acting as finders. There is not a bright-line standard to determine whether or not an individual is a finder; instead, authorities weigh several factors. These factors include (i) the level of services a finder is providing to a company and potential investors, (ii) the regularity in which a finder is engaged in the business of facilitating investments between companies and investors, and (iii) compensation received by a finder for his actions in the investment.

What is a broker-dealer?

Under federal securities laws, a broker is any person engaged in effecting transactions in securities for others. California law is very similar and defines a broker-dealer as any person engaged in the business of effecting transactions in securities in California. Under both federal and California law, if deemed a broker, an individual is subject to certain licensing and other regulatory requirements.

• Level of services

In determining whether an individual is a broker-dealer, authorities will consider the level of involvement the individual has in the transaction. To avoid the unlicensed broker-dealer label, a finder should do no more than make introductions between the company and the investors and avoid all involvement in negotiations between the parties. This factor was stressed in the first no-action letter issued by the SEC that recognized the finder exemption. In the Paul Anka no-action letter issued in 1991, the SEC found that an individual was merely a finder when he provided his contact list to the company and made introductions to potential investors. In making this finding, the SEC stressed the lack of any involvement in the negotiations of the transaction. Subsequent guidance has followed this initial finding. Therefore, to avoid being deemed an unlicensed broker-dealer, a finder should do no more than make introductions.

• Regularity of facilitating investments

An individual that regularly acts as a finder is in danger of being deemed an unlicensed broker-dealer. The Paul Anka no-action letter also brought this factor to light. In finding that the individual was not an unlicensed broker-dealer, the SEC focused on the fact that the individual in question had not previously arranged investments and that he agreed not to be involved in arranging investments in the future. If the individual had been involved regularly in these types of transaction, the SEC might have reached a different result. Because of this, companies should be wary of individuals acting as regular finders.

• Compensation

The SEC gives great weight to transaction-based compensation when determining whether an individual is acting as an unlicensed broker-dealer. It has gone as far as stating that transaction-based compensation is a hallmark of being a broker-dealer. Although transaction-based compensation does not automatically revoke the finder exemption, it definitely increases the risk of being deemed an unlicensed broker-dealer. Companies must be very careful when paying fees to finders and should try to avoid paying fees based on the amount of capital an individual is responsible for bringing in to the company. One possible option for a company to consider is to pay an upfront fixed fee to the finder, but the SEC has not stated whether such an arrangement would be acceptable.

Consequences of using an unregistered broker-dealer

Using an unregistered broker-dealer will subject a company to regulatory and individual actions. Regulatory actions by the states and the SEC may include questioning the reliance on a private placement exemption, prohibiting the company from future Regulation D offerings, company aider and abettor liability, and the unenforceability of the agreement between the company and finder. Rescission rights and individual actions by investors may also arise under California Corporation Code Section 25501.5.

With the passage of Corporation Code Section 25510.5, a fund sponsor who has raised funds, an entity that has raised capital or a seller of a company could all be subject to a rescission right by a buyer if an intermediary is involved who is paid a fee and is not properly licensed in California. Due to its recent passage, very little guidance exists at this time concerning the parameters of the rescission right provided for in California Corporation Code Section 25501.5. Comments to the assembly bill state that the bill was designed to address the problem of buck-

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Winning Strategies for Investing in a Volatile Economy

It's been a turbulent few years, to say the least. Families have struggled mightily in this economic environment, and the businesses and corporations that employ Americans are coping with these tough times, as well. Local, family-owned businesses face some of the toughest challenges in this economy.

By establishing an Investment Policy Statement for your company, educating yourself on risks and investment vehicles and choosing to work with a trusted financial advisor, business owners can better position themselves for success during uncertain economic times.

Put it in writing

"The first thing I look to, with a new or existing client, before beginning any discussions about their investments, is see if they have an Investment Policy Statement in place for the company," said Paul Cullen, Senior Vice President/Investments, Financial Consultant, Comerica Securities. "The importance of these policies is the objectives they serve: preservation of capital and maintaining the liquidity needs within the company on a monthly basis."

The Investment Policy Statement (IPS) is a roadmap for you and your financial advisor that clearly outlines which types of securities your company will invest in. The IPS states how your assets are to be allocated, the level of risk you are wiling to assume and your company's liquidity requirements.

It should be noted that an IPS is not a unique term for business investors, but should be considered by individual investors as well.

"Individuals need these as well. It's a good idea for individual investors to have a clear understanding of what they're investing in and what is appropriate for them," Cullen said.

An IPS is crucial for your company's financial protection. If your business does not currently have one in place, your broker or banker can help you create one.

Educate yourself

When deciding which investment vehicle is best suited to meet your company's needs, you must first determine the monthly liquidity needs of your company. This is an ideal time to make sure your budget is in order and you are presently able to meet all your expenses and needs in order to maintain your company.

Once you understand the level of assets you need to pay your non-negotiable expenses, such as rent, salary and insurance premiums, you can begin assessing the various options your business has for investment.

"Every situation is different," said Cullen. "Just as with an individual investor, where you place your funds depends on the level of risk you are willing to assume."

But because owning and operating a company presents a certain level of risk in and of itself, some business owners tend to view investing business capital skeptically.

"Many business owners already perceive their risk as being part of running their company," said Steve Kearns, Senior Vice President and Regional Manager, Comerica Wealth & Institutional Management. "As a result, the majority of owners are somewhat averse to risk when it comes to investing business capital."

That's the ultimate dilemma, according to Kearns – how much risk can and should be taken on your business capital versus the return on that capital you're going to receive. No one enters the market to lose money, but if you are already working on a tight budget, it is important to look at the cost-benefit analysis of entering into the market. However, when investing operating or reserve capital, business owners are trying to maximize their returns and actively mitigate risks whenever possible.

Fortunately, there are a wide variety of investment options for business owners of all sizes. There isn't a hard and fast rule for where to place your business capital, just like there are no fast truisms for individual investors. Some business owners are very risk averse, only placing a small amount into investments while some put their total business capital into the market.

Experts suggest striking a middle ground. The most conservative route would be to place your business capital into a Treasury Money Market Fund or a specific, dated Treasury bill or note. However, in today's interest rate environment you will see low yields on these specific securities.

For owners who will embrace some risk, short-term investment grade corporate bonds will show higher yields. While they return higher yields than government backed securities, they also carry a greater degree of risk that the company could default on the bond.

For most, a middle of the road option like a money market mutual fund is a good way to begin your investment plan.

"It is always advisable to have your money working for you," said Cullen. "But as a business owner you want to make sure preservation of capital and liquidity needs are at the forefront of any investment decision."

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>
> *Paul Cullen, SVP/Investments, Comerica Securities*

Work with a trusted advisor

As an investor, the best way to know which investment route is ideal for your situation is to consult a broker or advisor. How you go about choosing whom to work with is relatively straight-forward.

"Business owners typically work with their bank's securities division, though going to big investment groups is an option, just as it is for individual investors," said Cullen. "Obviously, whether you work with a bank or a firm, if there's a history of violations or inquiries, you'll want to investigate them more closely for your own security, or avoid working with them altogether."

Federal law requires brokers and advisers to be licensed or registered with the Securities and Exchange Commission (SEC) or state securities agency where they maintain their principle place of business. Advisors who manage $25 million or more in client work must register with the SEC. If they are under $25 million, they are required to register with the state securities agency.

It is a federal requirement for brokers, investment advisors and their firms to be registered with either the SEC or the state but it is the individual investor's responsibility to confirm that the group you work with has met these requirements.

It is also important to note if the brokerage firm you work with is a member of the Securities Investor Protection Corporation (SIPC). SIPC provides customer protection in the event that an investment firm becomes insolvent. Losses in market value are not protected, as those are not the fault of your broker, but if a firm were to go out of business, you would receive a portion of your investment back.

Once their credentials are established, always ask for references from your potential advisor.

"I'm often asked by new corporate prospects for a list of referrals," said Cullen. "I'm always eager to provide my prospects with a few clients, similar to their company, for consult. You're looking for someone who has corporate experience to handle your capital – why not ask others what their experiences have been with this particular broker?"

From the perspective of preventing fraud, Cullen and Kearns agree that scams are not as much of an issue with business capital investments as they are with individual investors. A business's IPS typically protects them from potential fraud and there is a cap on the types of securities they can buy. Volatile, low-grade purchases are not made under most guidelines and therefore, risky interactions are decreased significantly.

Set reasonable goals

Finally, make your money work for you in whatever capacity you and your business can afford. Despite the fact that the market has been volatile recently, there is still a benefit to investing either excess business capital or savings, and getting yields, even if modest.

"If you have excess, beyond your operating expenses, why not find a safe way to put it in the market and get a decent return back, rather than having it sit in a checking account, earning zero," Cullen said.

You and your broker can create a varied portfolio to help minimize your risk of loss. Based on analysis of your current liquidity needs, a broker may advise your portfolio to include money market funds, fixed income products and /or bonds.

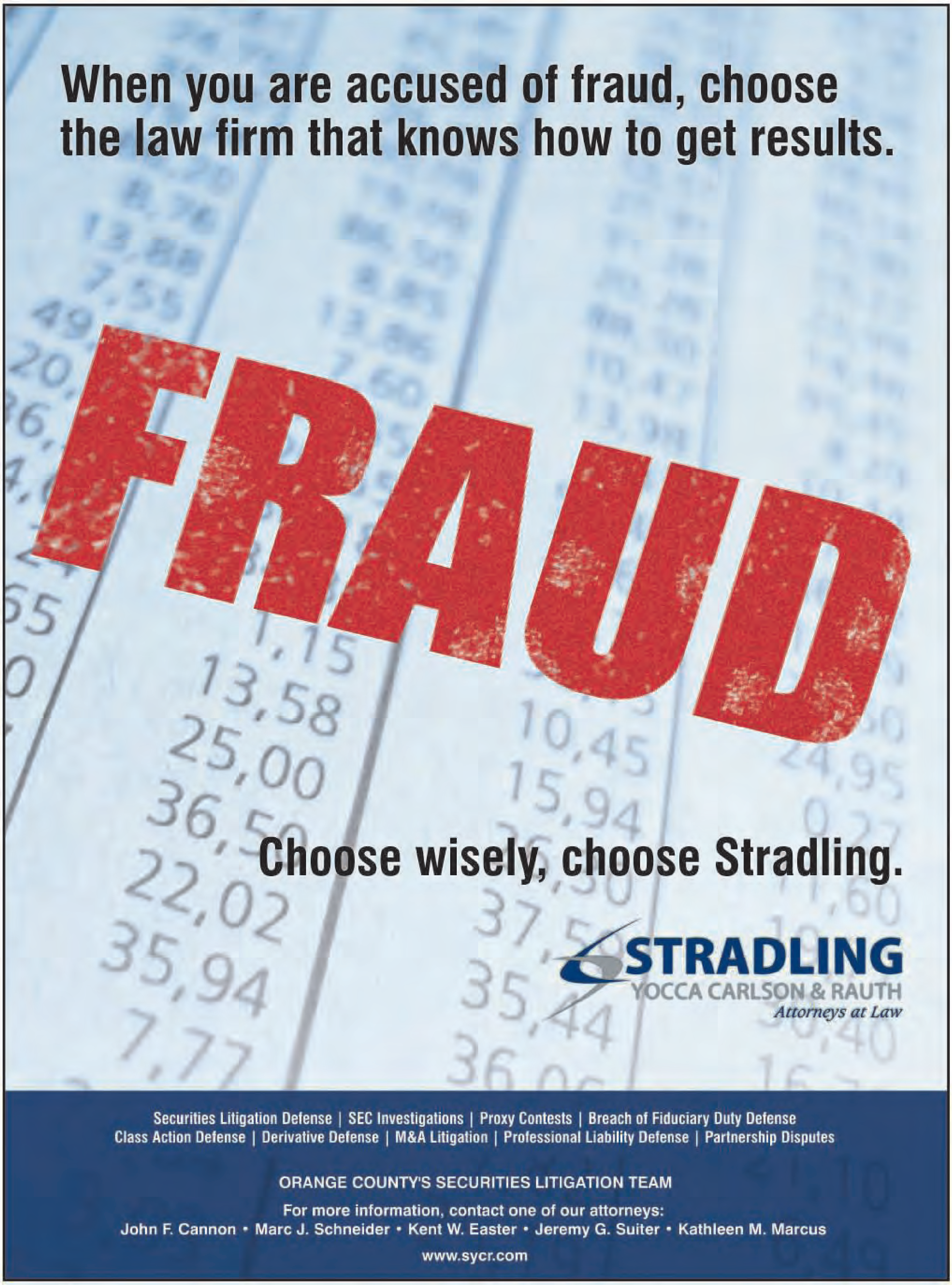
Risk is implicit in investing. The higher rate of return you expect on a security, the higher level of risk you assume. Depending on the ups and downs of the market, you could lose some or all of your initial investment. Before investing, find out whether a particular security can be redeemed or if there is market value associated with it.

It's also important to understand the long-term picture. As noted, risk is affiliated with any move in the market. If you invest in a Treasury Money Market fund, you'll most likely bring back a smaller yield annually. However, if you are able to keep that money in place, without affecting the liquidity of your business, over time those returns add up.

It is important to remember there are no guarantees with investing. Past success performance of a particular security is no guarantee for future success, so start conservatively.

At the end of the day, investing in securities is about providing growth opportunities to your existing assets. The job of your broker or banker is to answer any questions you may have and advise you with the best course of action at the time. For any questions about what should be expected of your broker, your investments or any other market related questions, the SEC has a helpful website at ***www.sec.gov.***

Additionally, Comerica Securities, Inc. is well-versed in small and large business advising. Do not hesitate to contact your advisor or local Comerica representative or visit us online at ***www.comerica.com.***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Revealing Impact of a Dim Economy:
A Deluge of Recent Ponzi Schemes

by David J. Darnell, Senior Attorney, Callahan & Blaine

Bernie Madoff's fraud on investors was certainly the largest in history – with actual losses of $18 Billion and estimates of fabricated gains as high as $65 Billion. But time has shown he was not the only one. In the 16 months since Madoff's arrest, a good number of other cases have come to light.

In February 2009, for example, the SEC filed civil charges against R. Allen Stanford and three of his companies for orchestrating a fraud tied to the marketing of $8 Billion in high-yield CDs. Like Madoff, this alleged Ponzi scheme came with financial statements and investment income the SEC has described as "fictional." A few months later, Stanford was arrested by the FBI and indicted on criminal charges. Stanford's personal assets, as well as those of his companies, are currently under court-ordered receivership and his criminal trial is set for January 2011. On the civil side, an investor's committee was formed to pursue actions against third parties to try to recover some of their losses if the court-appointed receiver decides not to sue them himself.

Last April, Art Nadel was indicted on 15 counts of securities, wire and mail fraud based on a Ponzi scheme with his hedge fund, Scoop Management. News of the Madoff case reportedly prompted business associates to demand an audit, which then prompted Nadel to disappear. He was later found and arrested in Florida, though much of the estimated $350 Million has yet to be accounted for.

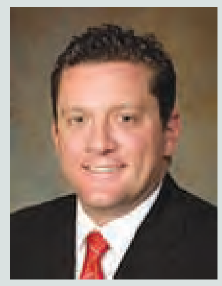
SoCal investors not immune

In addition to these cases, a number of other suits have garnered national attention. While Madoff and others like him may be little more than folks we read or hear about, the fraudulent investments they have become synonymous with – *Ponzi schemes* – are all too real for more than a few Orange County residents.

One need look no further than the Medical Capital case before Judge Carter in District Court right here in Orange County. Last August, the SEC filed suit alleging fraud on investors based on the wrongful taking of funds and misrepresentations about prior defaults and late payments. The case has since been described as one of the largest Ponzi schemes in Orange County history. While the SEC was able to obtain an emergency order and a receiver has been working to recover what he can for investors, some may fare better with lawsuits against third parties, such as the broker-dealers that sold the notes and others who may bear responsibility, though it remains to be seen.

Also close to home, and even more recently, the SEC filed a case last month over a $14.7 Million Ponzi scheme that targeted pensions of bus drivers in Los Angeles County. According to the complaint, an investment advisor encouraged the drivers to take a lump sum payment from their pensions and roll them into IRA accounts under his management. The drivers were lured by promises of annual returns of 10-15%, which the SEC says were false. The judge in that case has since granted the SEC's request for a temporary restraining order and frozen the assets of the investment advisor and his companies.

Financial meltdown sparks scrutiny



David J. Darnell

A significant number of other Ponzi lawsuits have also made recent headlines. In addition to all these cases, there are an even greater number of smaller cons, relatively speaking, that most have probably never heard of.

With all these scams of late, one has to ask why. Is it a sign of the times? Are there more swindlers today than in the past? Perhaps the media and Internet have just increased our awareness. In fact, some have said the SEC's embarrassment in failing to catch Madoff's scheme has caused the agency to pursue and run press releases for more and more of these cases since they fit the hot topic of the day.

Or perhaps it is the economy. Why not? It is an easy target that has taken blame for just about everything the last two years. But if you stop and think about it, the fact these frauds came to light in or after 2008, a year marked by global market turmoil and the financial sector meltdown, is not just coincidence.

The nature of the Ponzi scheme itself offers some explanation. The SEC defines a Ponzi scheme as an investment fraud involving payment of purported returns to existing investors from funds contributed by new investors. It is named after Charles Ponzi, who ran an international stamp redemption practice in the 1920s that claimed to reap annual net returns of more than a 400%! In Ponzi's case, his scheme grew too big, causing regulators to realize that more than 100 million stamp transactions were needed to substantiate the millions of dollars he raked in. With only 27,000 transactions on the books, something was clearly amiss and Ponzi was arrested and indicted in short order.

Absent government intervention, most Ponzi schemes can continue undetected unless it becomes difficult to recruit new investors or a large number of existing investors ask for the return of their principal. In other words, as long as there is a consistent flow of new money, the scheme has the possibility of forging ahead for a quite a long time, at least until regulators catch on or enough investors try to cash out.

Considering these characteristics, one can see how a declining economy can lead to revealing a fraudulent scheme for what it is. After all, when money is tight, existing investors are inclined to look closer at their current holdings. Some who are confident in a bull market may have second thoughts when things turn bear. This rationale can lead to increased liquidation or cashing out of investments, further drying up a fraudster's pool of available funds.

Additionally, in a down economy, there is simply less money to go around. Even those who are capable of investing may choose to sit "on the sidelines." In more difficult times, new investors may also be cautious of less traditional forms of investments, which many Ponzi schemes can be associated with. These factors, in turn, can make the scheme's organizer desperate and more likely to make outlandish promises or solicit unqualified investors, thereby drawing the eyes of regulators.

Beyond Ponzi schemes

Thus, the state of the economy since 2008 has contributed to the revelation of more and more Ponzi schemes. However, it is also important to understand that while the word "Ponzi" has become a popular catch phrase these days, not all cases fit within this category. Beyond Ponzi, investment frauds can range from the simple to the complex, and many can be tied, in part, to some form of legitimate business. Yet whether it is actually a Ponzi scheme or some other type of fraud, investor rights and remedies are usually triggered by some sort of material misrepresentation.

The good news is that regardless of the form of investment fraud, if you have been had, there may be help. You just need to know where and how to look for it. The laws in this area are designed to protect investors, and while every case is different, you will not know all of your options until you seek and find excellent advice.

David J. Darnell is a Senior Attorney with Callahan & Blaine who specializes in complex business, contract and commercial matters as well as disputes involving fraud and other intentional torts. Callahan & Blaine is known and respected as "California's Premier Litigation Firm." Mr. Darnell and the other attorneys at Callahan & Blaine have obtained outstanding results for clients in some of the most difficult and complex litigation matters. For more information, please visit the firm's website at www.callahan-law.com or call (714) 241-4444.

Prosecutorial Misconduct: A Powerful Tool for Defendants and Their Counsel

by Mike Piazza, Shareholder, & Donald Bunnin, Associate, Greenberg Traurig LLP

Prosecutorial misconduct is in the headlines often these days. The impact of that misconduct has, in certain circumstances, resulted in the dismissal of high profile criminal and civil actions. Orange County was the scene of the most recent example of this phenomenon when, in December 2009, U.S. District Judge Cormac J. Carney dismissed charges against and set aside a guilty plea of former Broadcom Corporation executives. The court also dismissed the U.S. Securities and Exchange Commission's enforcement action because the government's lawyers were guilty of "shameful" prosecutorial misconduct. Just a few months earlier, in August 2009, the Ninth Circuit came down hard on federal prosecutors in the San Francisco U.S. Attorneys Office because of their misconduct and reversed the conviction of the former chief executive officer of Brocade Communication Systems, Inc. And just one year ago, in the spring of 2009, because of admitted prosecutorial misconduct, the Justice Department dropped all charges against former Alaska Senator Ted Stevens, who had lost his Senate seat in 2008 just days after being convicted of seven felony counts of ethics violations.

Sadly, prosecutorial misconduct is nothing new, but these recent cases indicate an emerging trend. Given the rapid expansion of government size and power in the wake of the 2009 economic meltdown, this trend is disconcerting but also portends a potential defense strategy. Prior to the Broadcom, Brocade and Stevens cases, defense attorneys were more likely to view coercive tactics by federal prosecutors and law enforcement agents as a pitfall in the system that would be overlooked by the judiciary even if it was brought to the court's attention. These recent decisions, however, demonstrate the judiciary's apparent readiness to consider and act upon a defendant's claims of prosecutorial misconduct, at least in truly egregious cases. Indeed, just weeks after the Broadcom dismissals, the former-CEO of KB Homes, who is being prosecuted for stock options backdating, launched a prosecutorial misconduct defense accusing prosecutors of manipulating witnesses. Although the prosecutorial misconduct defense was rejected by the trial court, it is certain that this view of prosecutorial misconduct and the strategy of bringing it to the court's attention will become all the more common within the defense bar and in courtrooms across the country. To be sure, an effective defense will now more than ever need to include a keen eye on the conduct of the government's lawyers and agents.

Mike Piazza, Shareholder **Donald Bunnin, Associate**

The sudden and complete demise of the Broadcom criminal and civil prosecutions

In December 2009, U.S. District Judge Cormac J. Carney dismissed the criminal charges against Broadcom's former chief executive officer, Henry Nicholas, and former chief financial officer, William Ruehle, who were indicted for allegedly backdating Broadcom employees' stock option grants to increase employee compensation. Notably, the charges against Nicholas were dismissed even though his trial had not yet begun and no defense motion for dismissal was pending. Broadcom was one of the many tech companies that allegedly engaged in the improper backdating of stock options. Backdating stock options is not itself illegal, but it must be disclosed by the company and the extra value must be reported as a compensation expense, which lowers a company's profits. During much of the time tech companies were backdating stock options, the rules governing

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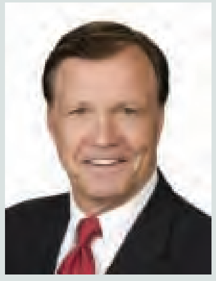
How to Save a Bundle on Financial Reporting

by Chris Cox, Partner, Bingham McCutchen LLP

There are more than 120 public companies in Orange County, and within the next year and a half, every one of them is going to have to change the way it files its financial information with the SEC. For most companies, the process will be painless; but unless a company is savvy, the process could also be needlessly expensive.



Chris Cox, Partner

Businesses have been complaining for years that the costs of being a public company are too high. From the Sarbanes-Oxley Act to new SEC disclosure guidelines on climate change, the costs of regulatory compliance keep mounting. Especially in these difficult economic times, companies, their investors, and their customers can ill afford any more unnecessary expense.

That's why it's so important for managers of public companies to recognize that the new requirement to file Form 10-Q and Form 10-K reports in "interactive data" format – using the XBRL computer language – need not add to the cost of SEC compliance and may, in fact, lead to cost reductions.

Because XBRL is still relatively new, there is a tendency to imagine that it is too complicated for in-house reporting managers to handle. In fact, the process of applying XBRL data tags to income statements and balance sheets is remarkably simple. Companies can buy the tagging software for as little as $1,000. It's not necessary to hire outside professionals to assist with the data tagging. (Anecdotal evidence suggests that third parties are charging prices ranging from $50,000-$100,000 to help with this process.) The software does most of the heavy lifting.

A cost and time saver

Once a company internalizes the use of XBRL, it can be a genuine cost saver. That's been the experience in other countries where XBRL is already required. Invariably, it leads to reduced costs to obtain and integrate financial data – a benefit not only for outside investors who rely on the financial statements, but also for in-house managers.

At an SEC Roundtable on interactive data, companies that participated in the SEC's pilot program for XBRL described their first-time experiences. They unanimously reported that the process was much easier than they had expected. In fact, these filers stated that their start-up costs were trivial. Not only did using interactive data require relatively little staff time, but it also reduced the work needed for subsequent filings.

United Technologies, one of the "early adopters" in the XBRL pilot program, was so enthused about its experience that their controller wrote a significant article about it in the *Journal of Accountancy.* The process of tagging and filing an 8-K earnings release, he said, took only four hours.

A year later, when United Technology's quarterly reporting process fully incorporated interactive data, the cycle times were faster and the staff time reduced. What's more, the risk of factual errors was reduced. Further savings will be achieved when the SEC allows submission of the XBRL document only, and no longer requires submission of the HTML version as well.

Free trials, free assistance

Of course, the main purpose behind XBRL is to benefit everyone in the market who uses financial reports.

Here in Orange County, public companies with a market cap of less than $700 million will be required to use XBRL starting with their 10-Qs in the summer of next year. (Larger companies will have to file in XBRL this year.) But waiting until next year, even for small companies, would be a big mistake. Filing in XBRL on a voluntary basis will give a company a free trial, with no risk and no liability, and by taking the time pressure off, the whole process will be cheaper and easier. Companies can even make free test filings, using the SEC's online validator to check for errors.

If companies have questions, calling the SEC's Office of Interactive Disclosure is an excellent source of quick answers. Alternatively, you can email Ask-OID@SEC.GOV with your question. Overlooking this free resource for your company could be an expensive mistake, because the SEC's experts are the people most familiar with the details of the new rules, and they're anxious to help.

So far, at least, companies are pleased to discover that their calls are quickly returned. That's because the agency has a big stake in the success of XBRL, and has made a significant effort to ensure that companies can understand the new requirements without having to hire outside help.

While many SEC requirements are complicated, the XBRL rule is straightforward. No additional liability attaches to the data tagging process and interactive data files are excluded from officer certification requirements, so auditors aren't required to audit them.

For most companies, it isn't necessary to hire lawyers, accountants, computer geeks, or any other outside experts to do the job because all the expertise that's needed is available for free. It would be unreasonable to expect, however, that this easy access to helpful experts will still be available in the summer of 2011, when all at once the bulk of over 19,000 public companies in the United States will have to meet the initial XBRL filing requirement at the same time.

Savvy companies will recognize that meeting the SEC's new interactive data requirements can be cheap and easy – but only if they start right now. Waiting until the last minute will leave no room for error, which risks making expensive outside help (at last-minute prices) the only option. This is one time when being an early adopter is likely to save your company a bundle.

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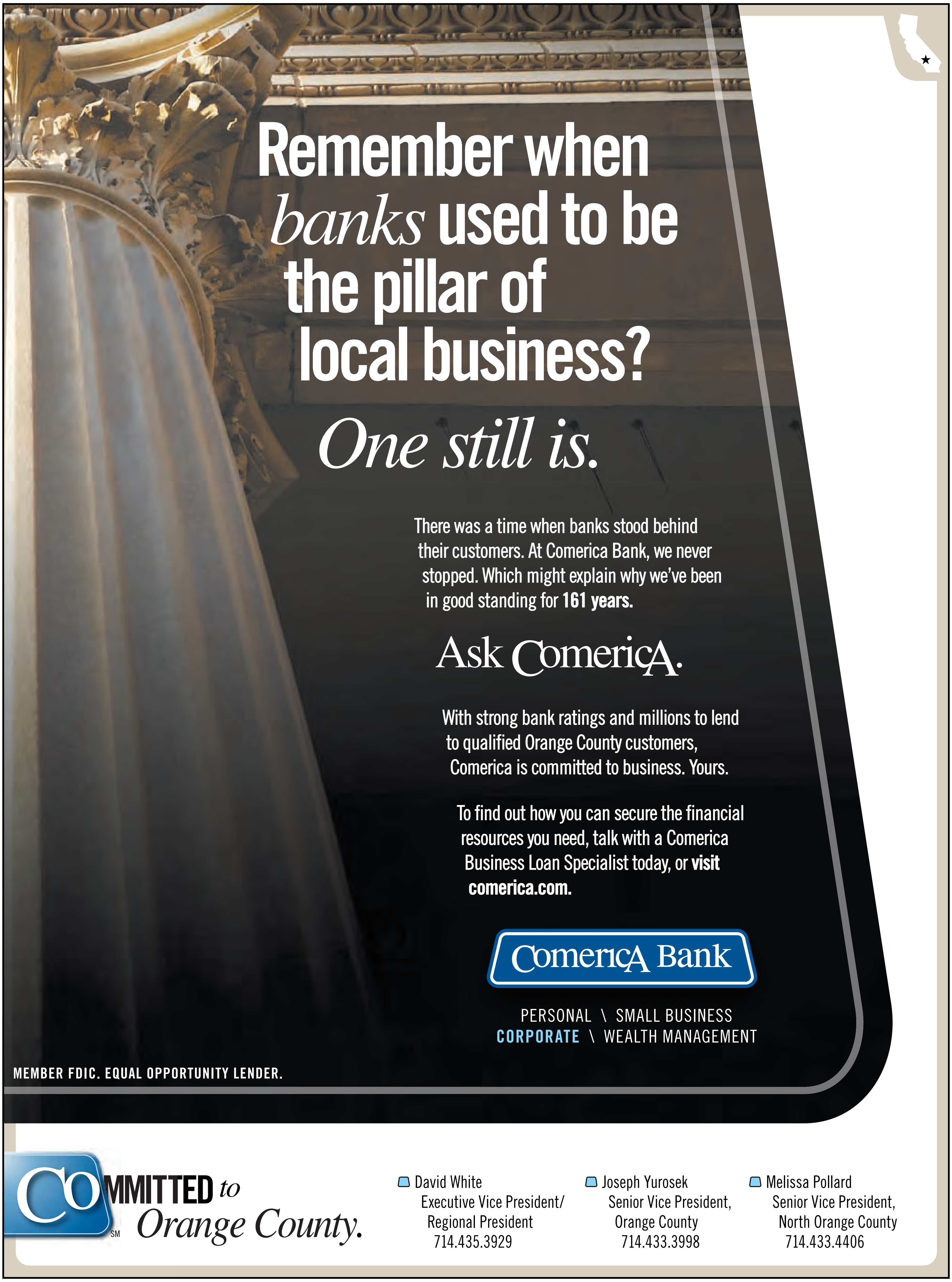
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Interest Rate Swaps

The Derivative Security that Creates a Better Fixed Rate Loan

by Everett Orrick, Senior Vice President and Manager, Citizens Business Bank

Most economists and interest rate pundits are predicting the return of inflation sometime before the end of the year, putting an end to the historically low interest rates of today. As a result, businesses and investors that purchased real estate, equipment and other long-term assets using variable interest rate loans or fixed rate loans with just a year or two to maturity are rushing to banks in an attempt to lock in a low rates of interest for as long as possible. Contrary to popular opinion, many top performing banks are flush with capital and are actively seeking to put that capital to work by extending long-term financing to new and existing customers, as long as the loan is part of a complete banking relationship.

As potential borrowers begin to explore their financing options, most are going to find that for credit needs in excess of a few million dollars and for a desired rate maturity in excess of 5 years, many banks no longer offer a traditional fixed rate loan product. Banks are just as worried as borrowers about the prospect of rising interest rates. A bank with a balance sheet full of term loans that were fixed at the low rates of the past few years is likely to see their profit margin on those loans erode as interest rates increase over time. Therefore, an increasing number of banks are requiring that customers in need of term debt either borrow on a floating rate, or use a combination of a floating rate and an ***interest rate swap*** to effectively lock in the interest rate on the client's loan.

Everett Orrick

The basics of an interest rate swap

In its basic form, a combination of a floating rate loan and a swap create the exact total monthly payments as a traditional fixed rate loan. Using a swap differs from a traditional fixed rate loan in that there are essentially two payments between a customer and the bank to create the equivalent of a fixed rate of interest. An interest rate swap is a separate financial contract which, when combined with a floating rate loan, synthetically fixes the underlying floating rate through the exchange of fixed versus floating interest payments.

Swaps can be flexibly structured to meet a borrower's exact financing requirements

The beauty of an interest rate swap is that it can be structured to match borrower's exact requirements in any interest rate environment. For example, if a borrower has a definite funding need several months out into the future and is worried about rates moving, there is a swap product available to lock that rate in today. In addition, if a borrower has some tolerance for the risk of interest rate movement, banks can structure a swap that is less expensive the usual synthetic fixed rate swap by incorporating interest rate caps and/or interest rate collars. ***Interest rate caps*** essentially limit how high the interest rate can go on a debt. ***Interest rate collars*** are used to create a range of rates around which the floating rate debt can float.

Loan payments when using an interest rate swap

Loan payments on a net basis are nearly the same when comparing payments made with a swap in place to loan payments made on a traditional fixed rate loan. The difference is that with a swap product, two payments are made. The first payment is always made by the customer to the bank for the underlying floating rate of interest. The second payment is for the swap contract. When rates go up, the bank makes a payment to the customer. When rates go down, the customer pays the bank. The net effect of the two payments is equal to the synthetically created fixed rate of interest.

The impact of downward movement in interest rates

In the typical interest rate swap designed to perfectly mirror a fixed rate loan, as interest rates decline, the borrower's overall rate does not change. This is accomplished because the interest payments on the underlying floating rate loan decrease at the nearly the same rate as the client's payments increase under his swap contract. The interest rate swap only hedges the underlying index on the loan, not the credit spread. Simultaneous to this decrease in the floating rate payment, a borrower will begin making higher payments under the terms of his interest rate swap.

In terms of risks to a client, if rates move lower and they wish to terminate the swap transaction there may be a cost to unwind it which would be referred to as a market value loss. However, the market value loss will frequently be much less than the prepayment premium often charged on a traditional fixed rate loan. As long as the loan is outstanding, the net cost of a swap and fixed rate loan is the same. Regardless of which direction rates move, the customer locks in a fixed rate of interest.

The impact of increasing interest rates on swaps

If interest rates rise and a borrower wants to terminate the swap contract, it is likely that the interest rate swap would have a market value gain and the client will be paid to terminate the transaction. This can be compared to a borrower essentially receiving a prepayment penalty from the bank that he entered into a swap contract with. Compared to a fixed rate loan, this can be a major advantage to using a swap. When have you ever heard of a bank paying you to prepay a low interest fixed rate loan?

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et shops or boiler rooms that engage in securities fraud and to specifically target disreputable brokers who victimize consumers by operating illegally, such as unlicensed persons who sell mortgage pools, pyramid or Ponzi schemes, and persons licensed in a related field, like insurance, who sell securities to their existing clients without obtaining the proper securities licenses. Except in the case of these unusual securities, most finders do not own the securities they sell and are acting as an agent of the company.

Section 25501.5 provides two alternative remedies if a violation has occurred. First, if the purchaser still owns the security, the purchaser may bring an action for rescission and tender the security. If a rescission occurs, the statute provides that the purchaser may recover the consideration paid for security plus the legal rate of interest, less the amount of any income received on the investment.

Secondly, if the purchaser no longer owns the security, the purchaser may sue for damages. Damages recoverable are in an amount equal to the difference between the price at which the security is bought plus the legal rate of interest reduced by the value of the security at the time it was disposed of by the purchaser plus any income previously received by the purchaser on the security.

In addition to the foregoing remedies, a court is empowered, in its discretion to award reimbursement of reasonable attorney fees to a prevailing plaintiff under this section.

Conclusion

As a matter of course in connection with any sale of a business or fund raising in which an intermediary is involved who is to receive compensation, an analysis must be made whether such individual is truly a finder or, if not, whether such person is properly licensed. If such intermediary is not properly licensed in California risk exists under Corporation Code Section 25501.5 that a rescission right will exist or that a damage claim may exist if the security in question has been sold.

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GREENBERG

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stock option accounting were murky and they were not clarified until 2005. In 2007, Broadcom reduced its earnings from 1998 to 2005 by $2.22 billion for underreported compensation expenses associated with backdating stock options, the largest backdating restatement ever.

The dismissal of the cases against Nicholas and Ruehle came less than a week after Judge Carney set aside the guilty plea of Henry Samueli, a co-founder and former chairman of Broadcom. The guilty plea mandated the maximum fine of $250,000 and a $12 million penalty. Interestingly, a year earlier, Judge Carney rejected Samueli's guilty plea because it did not include any jail time. Yet after listening to Samueli's testimony in the Ruehle trial, Judge Carney set aside the guilty plea. In Judge Carney's view, the government's treatment of Samueli "was shameful and contrary to American values of decency and justice." As with Nicholas, Judge Carney acted with respect to Samueli even though he was not on trial at the time and no defense motion was pending.

Judge Carney's dismissal of the criminal charges and setting aside of the guilty plea were based on evidence that federal prosecutors had employed a "shameful" campaign of witness intimidation in order to obtain unjustified convictions. "To submit this case to the jury would make a mockery of Mr. Ruehle's constitutional right to...a fair trial," Judge Carney declared. "The lead prosecutor somehow forgot that truth is never negotiable." In particular, the lead federal prosecutor leaked information about the grand jury testimony of Samueli to newspapers in an effort to force him to plead guilty. The government prosecutor told the Los Angeles Times and Wall Street Journal in 2007 that the government was having difficulty getting Samueli to cooperate in its investigation. The prosecutor also attempted to coerce the testimony of Broadcom's former general counsel after Judge Carney granted him immunity. The prosecutor told the lawyer for the former general counsel that he could be prosecuted for perjury if he testified as he had in a deposition before the Securities and Exchange Commission. Additionally, Broadcom's former head of human resources lost her job at a different company after the prosecutor contacted her new employer and disclosed allegations against her. Thereafter, the witness agreed to plead guilty to obstruction of justice, a charge Judge Carney viewed as "questionable," and testified in a manner that seemed "scripted."

If the dismissal of the criminal indictments and the setting aside of a guilty plea were not enough, Judge Carney also dismissed the civil complaint filed by the Securities and Exchange Commission against Nicholas, Ruehle, Samueli and one other individual. Although it was given an opportunity to amend its complaint, in February 2010, the Securities and Exchange Commission decided not to pursue its backdating case, citing remarks made by Judge Carney questioning its merits. The Commission's decision not to move forward is a bit curious given its recent public pronouncements about stepping up enforcement activities and getting tougher on corporate malfeasance. Robert Khuzami, the Director of the Division of Enforcement at the Securities and Exchange Commission, has attempted to adopt an enforcement model akin to the Department of Justice where the SEC seeks "prosecutions" as opposed to "enforcement actions." In particular, Khuzami wants to go after alleged wrongdoers using proffer agreements, cooperation agreements, deferred prosecution agreements and non-prosecution agreements. These are tools long used by the Justice Department but previously not adopted by the Securities and Exchange Commission. Although its just one example, the decision not to pursue the Broadcom case seems to be contrary to Khuzami's pledge to be proactive. Nevertheless, Khuzami's efforts within the Securities and Exchange Commission mean that defendants and their counsel must be concerned with both the Department of Justice and the Securities and Exchange Commission.

Defendants and their counsel need to vigilantly monitor the conduct of prosecutors and their agents and raise any concerns with the court

What the Broadcom, Brocade, Stevens and KB Homes cases illustrate is that defendants and their counsel must be vigilant in their monitoring of any signs of prosecutorial misconduct. What is more, they need to raise their concerns with the court. The federal judges in the aforementioned cases have shown their willingness to carefully examine the government's conduct and to take swift action, including dismissing charges, overturning prosecutions and setting aside guilty pleas, where the interests of justice require as much. Long gone are the days where defense counsel needs to let unseemly government conduct pass. Defendants are now within a justice system that fairly rebukes misconduct – prosecutorial or otherwise – and must recall that while a prosecutor "may strike hard blows, he is not at liberty to strike foul ones. It is as much his duty to refrain from improper methods calculated to produce a wrongful conviction as it is to use every legitimate means to bring about a just one." *Berger v. U.S.*, 295 U.S. 78, 88 (1935).