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SECURITIES ENFORCEMENT DEVELOPMENTS

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What follows are some recent developments in securities enforcement that our clients and other friends may find of interest:

Annette Nazareth's departure leaves the Commission with three Republican and no Democratic Commissioners.

Our take: The conventional wisdom is that Commissioner Nazareth's departure from the SEC will result in a slowing of the enforcement process, because at least some of the remaining Commissioners are perceived as hostile towards the Division of Enforcement. There has been no word from the White House about when it expects to appoint Democratic commissioners. Until there is, we expect some scrutiny from the press and from the Congress about the pace of the enforcement program. To preempt any criticism, the Commission may move cases more quickly.

The sub-prime enforcement season is officially open.

The Massachusetts Secretary of State brought a civil lawsuit alleging that Merrill Lynch sold the City of Springfield unsuitable securities, namely a $13.9 million tranche of a collateralized debt obligation linked to sub-prime mortgages. Investigations are underway by the Department of Justice, the SEC, and various state attorneys general.

Our take: The case is small but significant because other states, the SEC, and the DOJ will feel pressure to bring their own cases more quickly. These complex cases are hard to investigate and even harder to explain to courts and juries. But given the widespread pain from the sub-prime crisis, the pressure to bring cases soon will be enormous.

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This memorandum was prepared as a service to clients and other friends of Cleary Gottlieb to report on recent developments that may be of interest to them. The information in it is therefore general, and should not be considered or relied on as legal advice.

The White House proposes a flat budget for the SEC.

The White House has proposed an essentially flat budget for the SEC. There will be no appreciable additional resources for the SEC's enforcement program. Staff attrition rates are up after a decline in the years immediately following enactment of the Sarbanes-Oxley Act.

Our take: While the SEC announced that it brought record numbers of cases in 2006, there were fewer blockbusters than in previous years. The budget request suggests that this trend will continue.

The SEC brings an administrative proceeding against a lawyer for his conduct in representing a witness in an enforcement proceeding.

The SEC instituted an administrative proceeding against a lawyer for a witness in a previous SEC administrative proceeding. According to the complaint, the lawyer's client was an employee of the broker-dealer sued by the SEC. The lawyer allegedly [asked for] a "severance package" on behalf of his client, in return for which the client would fail to cooperate with the SEC's Division of Enforcement and "forget" relevant information. *In re Steven Altman, Esq.* (File No. 3-12944).

Our take: It is very unusual for the SEC to discipline lawyers for their conduct representing parties, much less witnesses, in SEC proceedings, for fear of being seen as interfering with the attorney-client relationship and the adversary process. The facts alleged here, though, look egregious. The question is whether this case is the thin end of a wedge or whether it is a once-in-a-blue-moon event.

Sentencing in options backdating criminal cases goes forward, and SEC nears end of its investigations.

Brocade's chief executive officer, the first person to be charged with a crime in the options backdating scandal, was sentenced to 21 months in prison. Separately, SEC Enforcement Director Linda Thomsen said in remarks at a conference that the SEC has 80 backdating investigations still open (out of 160 opened initially) and that she expects the Commission will decide which cases to bring and which to drop by the end of 2008.

Our take: The Commission will bring a small fraction of cases out of the 80 investigations still open. Many of the open investigations involve old conduct; backdating largely stopped with the passage of the Sarbanes-Oxley Act in 2002. Since backdating is not itself unlawful, these are cases about false financial statements or false statements in proxy materials, cases where intent is always hard to prove.

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