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## SEC Dismisses "Failure to Supervise" Enforcement Proceeding Against Broker-Dealer General Counsel

In a significant case for legal and compliance professionals at securities firms, the Securities and Exchange Commission (the "Commission") yesterday dismissed enforcement proceedings against Theodore W. Urban, former General Counsel of Ferris, Baker Watts, Inc. ("FBW").<sup>1</sup> The dismissal of the proceedings, by an evenly divided Commission, rendered "of no effect" a prior administrative law judge decision that had raised widespread industry concerns because of its broad construction of the circumstances in which a legal or compliance professional could be deemed a "supervisor."<sup>2</sup>

The Division of Enforcement, in proceedings commenced in 2009, alleged that Mr. Urban (i) had been the supervisor of an FBW employee, Stephen Glantz, who allegedly engaged in violations of the securities laws, and (ii) had "failed reasonably to supervise" Mr. Glantz under both Section 15(b) of the Securities Exchange Act of 1934 (the "Exchange Act") and Section 203(f) of the Investment Advisers Act of 1940 (the "Advisers Act").<sup>3</sup> The Commission's chief administrative law judge determined, in her Initial Decision in the matter, that Mr. Urban should be viewed as Mr. Glantz's "supervisor," even though Mr. Glantz was not a member of any department reporting to Mr. Urban, but she dismissed the Division's petition on the grounds that Mr. Urban had reasonably discharged his duties as a supervisor.<sup>4</sup>

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<sup>1</sup> Mr. Urban was also an Executive Vice President and member of the Board of FBW. FBW, a registered broker-dealer and investment adviser, now conducts business under the name "RBS Wealth Management" after its acquisition by the Royal Bank of Canada in 2008.

<sup>2</sup> Admin Proc. File No. 3-13655; Rel. No. 34-66259 (Jan. 26, 2012), available at <http://www.sec.gov/news/digest/2012/dig012612.htm>.

<sup>3</sup> The Enforcement Division's allegation included that Mr. Urban had failed reasonably to supervise Mr. Glantz within the meaning of both Section 15(b) of the Exchange Act and Section 203(f) of the Advisers Act.

<sup>4</sup> Admin. Proc. File No. 3-13655, Initial Decision Rel. No. 402 (Sept. 8, 2010), available at <http://www.sec.gov/litigation/ajidec/2010/id402bpm.pdf>.

In reaching her decision, the chief administrative law judge took a very expansive approach to determining when a senior legal and compliance professional should be deemed a “supervisor” under the federal securities laws, in reliance on the Commission’s Section 21(a) Report in *John H. Gutfreund*.<sup>5</sup> While the judge recognized that Urban “did not have any of the traditional powers associated with a person supervising brokers and the facts and circumstances of his situation are very different than in *Gutfreund* and its progeny,” she explained that “[a]s General Counsel, Urban’s opinions on legal and compliance issues were viewed as authoritative and his recommendations were generally followed by people in FBW’s business units, but not by [the unit in which Glantz worked]. Urban did not direct FBW’s response to dealing with Glantz, however, he was a member of the Credit Committee, and dealt with Glantz on behalf of the committee.” The judge explicitly recognized that “the language in *Gutfreund*, taken literally, would result in Glantz having many supervisors because many people at FBW acted to affect Glantz’s conduct in a variety of different ways.”

The Commission reviewed the Initial Decision on cross appeals by the parties. In light of the broad definitional approach to the term “supervisor” adopted in the decision – which potentially would have encompassed a wide range of legal and compliance professionals engaged in ordinary functions – briefs in the appeal were filed by several *amici curiae*.<sup>6</sup> As noted above, however, the Commission was evenly divided on the matter and thus, under applicable rules, the proceedings against Mr. Urban were dismissed and the Initial Decision was rendered “of no effect.”<sup>7</sup>

The dismissal of the Initial Decision, while eliminating a potentially significant adverse precedent, leaves for future consideration considerable open questions regarding the contexts in which legal and compliance professionals may be held liable as “supervisors” for employees outside their departments.

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<sup>5</sup> Exchange Act Release No. 31554, 52 SEC Docket 2849, 1992 WL 362753 (Dec. 3, 1992). *Gutfreund* states that one is a supervisor if one has the “requisite degree of responsibility, ability or authority to affect the conduct of the employee whose behavior is at issue.” (emphasis added). In this connection, *Gutfreund* cites to a significant concurring opinion in *In re Huff*, which concludes that a supervisor is someone who has the “power to hire or fire, and to reward or punish” or, if the purported supervisor does not have these powers, then he “knew or should have known that he had the authority and responsibility within the administrative structure . . . to exercise such control . . . that he could have prevented [the employee’s] violations.”

<sup>6</sup> Briefs were filed on behalf of *amici curiae* The Securities Industry and Financial Markets Association, including its Compliance & Legal Society, and the Association of Corporate Counsel (who filed jointly), and the National Society of Compliance Professionals.

<sup>7</sup> Commission Rule of Practice 411(f), 17 C.F.R. § 201.411(f). (“In the event a majority of participating Commissioners do not agree to a disposition on the merits, the initial decision shall be of no effect, and an order will be issued in accordance with this result.”)



Cleary Gottlieb served as counsel to *amici curiae* The Securities Industry and Financial Markets Association, including its Compliance and Legal Society, and the Association of Corporate Counsel.

Please feel free to contact any of your regular contacts at the firm or any of our partners and counsel listed under White-Collar Defense, Securities Enforcement and Internal Investigations in the “Practices” section of our website (<http://www.clearygottlieb.com>) if you have any questions.

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