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# Hedge Fund Report – Summary of Key Developments Thus Far in 2009

BY THE INVESTMENT MANAGEMENT, SECURITIES LITIGATION AND TAX PRACTICES

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In response to nearly unprecedented disturbances and failures in the global capital markets in 2008, the Obama administration, lawmakers and regulators have proposed a variety of significant legal and regulatory reforms thus far in 2009. These proposed reforms have the potential to change the nature of financial services regulation in the United States and beyond for years to come. Meanwhile, the Securities and Exchange Commission (the "SEC") and private litigants have been busy sorting through the aftermath of 2008 as evidenced by recent enforcement actions and litigation. This report highlights certain of these key developments as they relate to the hedge fund industry and also contains links to a number of more in-depth treatments of these important topics. The report is divided into four main sections: (I) new and proposed securities-related legislation and regulation, (II) new and proposed changes to the tax law, (III) civil litigation-related developments, and (IV) regulatory enforcement-related developments. Paul Hastings attorneys are available to answer your questions on these, and any other, developments affecting hedge funds, their investors and their advisers.

## I. NEW AND PROPOSED SECURITIES-RELATED LEGISLATION AND REGULATION

### *A. Overview of the Obama Administration's Financial Regulatory Reform Proposal*

On June 17, 2009, the Obama Administration released its Comprehensive Plan for Regulatory Reform of the U.S. Financial System (the "Proposal"). The Proposal is extremely broad in scope and has the potential to affect almost every aspect of the U.S. financial services sector. Among other initiatives, the Proposal calls for:

- The creation of a new Financial Services Oversight Council, which would be responsible for gathering information from participants in the financial markets in order to identify potential "systemic" risks.
- Providing the Board of Governors of the Federal Reserve System (the "Fed") with the power to supervise all large financial institutions that pose systemic risks, including institutions that are not otherwise subject to regulation or supervision by the Fed. The Proposal refers to these large financial institutions as "Tier 1 FHCs" (Tier 1 financial holding companies). Under the Proposal, Tier 1 FHCs would be subject to heightened capital, liquidity and risk management standards.
- The creation of a new Consumer Financial Protection Agency (the "CFPA"), which would be responsible for regulation of all financial products and services. The CFPA would be an independent agency with rulemaking, supervisory, examination and enforcement authority. The CFPA would be charged with simplifying financial products and services provided to U.S. consumers.
- Maintaining the SEC and the Commodities Futures Trading Commission (the "CFTC") as separate agencies, but requiring the SEC and the CFTC to "harmonize" their regulation of futures and securities. The Proposal also requires the SEC and CFTC to develop comprehensive regulation for over-the-counter derivatives.
- Requiring advisers to private investment funds (including hedge funds, private equity funds and certain real estate funds) to register with the SEC under the Investment Advisers Act of 1940, as amended (the "Advisers Act").
- Consolidating the Office of Comptroller of the Currency and the Office of Thrift Supervision into a single regulator, the National Bank Supervisor, in order to reduce the ability of banking institutions to "shop" for a regulator.
- Requiring the SEC to reform the money market industry.
- Mandating a number of changes to the securitization markets designed to improve market structure and integrity (e.g., requiring loan originators to retain a specified interest in the risk of securitized credit exposures, reducing reliance on credit ratings agencies and imposing additional reporting requirements on issuers of asset-backed securities).
- Establishing an Office of National Insurance within the Treasury Department to gather information and coordinate regulatory efforts relating to the insurance industry.
- Reevaluation of the role of Government-Sponsored Entities (e.g., Fannie Mae and Freddie Mac).

- Increasing cooperation among governments across the globe relating to improved financial markets oversight, strengthened capital requirements for, and enhanced supervision of, multinational firms and improved crisis management.

Each of these proposed initiatives would affect the hedge fund industry. Obviously, the proposals relating to the registration of private fund managers (see more on this below) are most likely to directly affect hedge funds, their investors and their managers. Other proposed reforms, however, would affect the hedge fund industry by imposing restrictions on various securities and instruments in which hedge funds invest.

As part of its effort to "fill" certain regulatory "gaps," the Proposal calls for all advisers of "private pools of capital" with assets under management in excess of some "modest" threshold to register with the SEC under the Advisers Act. Advisers with assets under management over the to-be-determined threshold would be required to register irrespective of the number of clients they serve.

In addition to the current record-keeping and compliance requirements under the Advisers Act, advisers would also be responsible for ensuring that their funds comply with new record-keeping requirements, disclosure requirements (which would mandate certain disclosures be made to investors, creditors and counterparties) and other additional regulatory requirements to be developed by the SEC under the broad grant of authority provided to that agency by the Proposal.

Private funds with sufficient assets and/or trading activities could also be classified as Tier 1 FHCs subject to regulation by the Fed. Under the Proposal, Tier 1 FHCs are subject to capital requirements that require them to maintain enough high-quality capital during good economic times to remain above prudential minimum capital requirements during stressed economic times. Tier 1 FHCs would also be subject to liquidity risk requirements designed to mitigate the potential negative impact that financial distress, rapid deleveraging or disorderly failure of a Tier 1 FHC could have on the broader financial system. Tier 1 FHCs would also be subject to certain restrictions on their "non-financial" activities. Each of these restrictions appears to have been designed with more traditional banking and financial institutions in mind. As such, it is yet unclear how they would apply to private investment funds and their advisers.

The Proposal also contains a call to regulatory authorities to implement the G-20 commitment to require hedge funds or their managers to register and disclose appropriate information to regulators in their respective home countries.

To date, the Obama administration has had little success in pushing the Proposal forward as it has been focused on one of the President's most central initiatives – health care reform. Additionally, recent signs of improvement in the economy and the relatively strong performance of U.S. and international equity markets in the past few months may have dulled the sense of urgency that existed before the Proposal was released this summer. Reform efforts have also been stymied, in part, by infighting among different regulators, who each seek to preserve their authority and relevance under any new regulatory regime. Indeed, one frequently suggested reform, the merger of the SEC and the CFTC, was notably absent from the Proposal. The lack of progress on the Proposal, in some respects, mirrors other regulatory reform efforts that have stalled thus far in 2009. The proposed ban on "naked" credit default swap trading,[1] which appeared to be an inevitability in the beginning of 2009, has not seen significant progress; nor have certain efforts by state legislatures (e.g., Connecticut) to take action ahead of Congress in the regulation of hedge funds and their advisers. Similarly, proposed restrictions on short sales appear to be attracting considerably less attention than they were only a few months ago. Nonetheless, the administration and key Democrats have indicated

their continuing desire to move the Proposal forward, and it is possible that a downswing in the stock market or the revelation of another scandal in the financial services industry might reenergize calls for sweeping reform.

### *B. Other New and Proposed Securities-Related Legislation and Regulation*

*1. Proposed Legislation Could Regulate Manager Performance Compensation*

On July 31, 2009 the House passed the Corporate and Financial Institution Compensation Fairness Act of 2009. This legislation would require appropriate federal regulators to adopt disclosure requirements applicable to, among others, larger hedge fund managers (i.e., assets of $1 billion or more), that would enable the regulators to determine if a manager's performance compensation is aligned with sound risk management, appropriately structured to account for the time horizon of risk, and meets such other criteria as the regulators may determine to be appropriate to reduce unreasonable incentives for fund managers to take undue risks. The language of this legislation is extremely broad and, in places, vague. Some industry participants believe that, if passed, it will, at best, regulate performance compensation or, at worst, impose an outright prohibition or a percentage limitation on performance compensation.

*2. Regulation of Short Sales and Derivatives*

The new administration has also introduced legislation to regulate certain trading practices frequently employed by hedge fund managers. In July 2009, the Commission introduced new legislation intended to curtail the unrestricted use of short selling. The new rule makes permanent the Interim Temporary Rule 204T of Regulation SHO that sought to reduce the potential for "naked" short selling in the securities market. The new rule, Rule 204, would require broker-dealers to promptly purchase or borrow securities to deliver on a short sale. The Commission also announced its current efforts to make more short sale information (e.g., sale volume and transaction data) available to the public through several self-regulatory organizations' websites. In addition to imposing a prohibition on "naked" short selling, the Commission announced that it is actively considering proposals for imposing a short sale price test and circuit breaker restrictions.

In August 2009, the Obama administration introduced the "Over-the-Counter Derivatives Markets Act of 2009." If enacted, the proposed legislation will provide for comprehensive regulation of the previously unregulated markets for credit default swaps and other other-the-counter derivatives. This regulation would impose limitations and additional costs on the generally unrestricted use of derivative instruments that hedge fund managers rely upon to generate high investor returns and to hedge against losses.

*3. Changes to Form D and Related Filing Requirements*

Effective March 16, 2009, all Form D filings with the SEC are required to be made electronically online using the SEC's EDGAR system. Additionally, issuers involved in ongoing offerings (e.g., most hedge funds) are required to make annual updates to a previously filed Form D. This new requirement is in addition to the requirement that issuers file amendments to a previously filed Form D following the occurrence of certain events. Additional information on these new requirements is available here.

*4. Proposed Changes to the Custody Rule*

On May 14, 2009, the SEC proposed amendments to Rule 206(4)-2 under the Advisers Act (the "Custody Rule"). The amendments are designed to provide additional safeguards to investors in situations in which an adviser is deemed to have custody of client funds or securities. The proposed

amendments would require all registered investment advisers that have custody of client assets or securities to undergo an annual surprise examination by an independent public accountant to verify client holdings. Additionally, advisers maintaining custody with a qualified custodian that is a "related person," such as a broker-dealer or bank that is under common control with the adviser, would be required to obtain a written report from an independent public accountant that includes an opinion regarding the qualified custodian's controls relating to custody of client assets. The amendment would also require that quarterly financial statements be delivered to clients directly by the qualified custodian. Currently, such statements may instead be delivered by the adviser. Additional information on the SEC's proposal is available here.

*5. Proposed Rules Designed to Prevent "Pay-to-Play"*

On August 3, 2009, the SEC published proposed rules that would (i) prohibit investment advisers from compensating placement agents to market private funds to certain governmental entities, and (ii) restrict political contributions by investment advisers and certain of their employees. The new rules come following revelation of a number of alleged scandals relating to investment advisers paying for "access" (in the form of political contributions, kickbacks and "sham" placement fees) to state employees responsible for directing the investment of state funds, including state pension plans. The proposed rules have the potential to change radically the way hedge funds advisers attract new investors and may have the unintended result of putting smaller advisers who lack a dedicated in-house marketing team at a significant competitive disadvantage. Additional information on the proposed rules and their potential consequences is available here.

*6. Proposed Legislation for the Regulation of Investment Advisers to Private Funds*

So far, 2009 has seen a number of legislative calls for the mandatory registration of most investment advisers to private funds. One early incarnation came in the form of the "Hedge Fund Transparency Act of 2009" (the "HFTA"), proposed by Senators Grassley and Levin on January 29, 2009. The HFTA would eliminate the exclusions from the definition of "investment company" currently provided in Section 3(c)(1) and 3(c)(7) of the Investment Company Act of 1940, as amended (the "Investment Company Act"). The HFTA would replace these exclusions with two new exemptions that would prevent private funds from being subject to many of the substantive requirements of the Investment Company Act, but would still require the advisers to such private funds to register with the SEC. Additionally, the HFTA would subject private funds with assets of $50 million or more to a number of additional regulatory and reporting requirements. Additional information on the HFTA is available here.

On January 27, 2009, Representatives Castle and Capuano introduced the "Hedge Fund Adviser Registration Act of 2009 (the "HFARA"). The HFARA would strike Section 203(b)(3) from the Advisers Act. Section 203(b)(3), which is commonly referred to as the "private adviser" exemption, provides relief from SEC registration requirements to any investment adviser who (i) has had fewer than fifteen clients during the preceding twelve months, (ii) does not advise registered investment companies or regulated business development companies, and (iii) does not hold itself out to the public as an investment adviser. A significant number of investment advisers are currently able to rely on the private adviser exemption, in part, because each fund they advise, as opposed to each investor in such fund, is counted as a single "client" for purposes of the exemption. Thus, the elimination of Section 203(b)(3) from the Advisers Act would require a significant number of advisers to register with the SEC.

On June 16, 2009, Senator Reed of Rhode Island introduced the "Private Fund Transparency Act of 2009" (the "PFTA"), which was followed by the "Investor Protection Act of 2009" (the "IPA") and the

"Private Fund Investment Advisers Registration Act of 2009" (the "PFIARA"), the latter two of which were proposed by the Obama administration on July 10, 2009 and July 15, 2009, respectively. The primary goal of the PFTA and the PFIARA is to require registration of advisers to any private fund (defined to be any pooled investment vehicle excluded from the definition of "investment company" under Section 3(c)(1) or 3(c)(7) of the Investment Company Act). The PFIARA also treats a fund organized outside the U.S. as a private fund if 10 percent or more of its outstanding securities are owned by U.S. persons. The PFIARA attempts to implement certain aspects of the Obama administration's Proposal (see above) by authorizing the SEC to require registered investment advisers to maintain and submit to the SEC and the Fed any reports regarding the private funds they advise determined to be "necessary or appropriate in the public interest" for the assessment of "systemic risk" (a term that is not defined in the PFIARA). The IPA would significantly increase the SEC's authority to adopt new regulations to govern the activities of registered investment advisers. Specifically, the IPA would grant the SEC additional authority to regulate (i) sales practices, (ii) conflicts of interest, and (iii) compensation schemes that the SEC deems to be contrary to the public interest and the interest of investors. Additional information related to this proposed regulation is available here.

*7. Key European Developments: Regulation of Alternative Investment Fund Mangers; UCITS IV*

On April 29, 2009, the European Commission (the "EC") of the European Union (the "EU") published its "Proposal for a Directive of the European Parliament and of the Council on Alternative Investment Fund Managers" (the "AIFM Proposal"). The AIFM Proposal, which is planned for implementation in 2011, would regulate managers of alternative investment funds ("AIFMs") that are either domiciled in the EU or that offer alternative investment funds (including hedge funds, private equity funds, real estate funds and infrastructure funds) to EU investors. The AIFM Proposal would subject covered AIFMs to a number of significant regulations relating to marketing, capitalization, operations, disclosure and reporting, investment restrictions, valuation protocols and custody of fund assets. The AIFM Proposal has been heavily criticized by AIFMs, particularly those in the United Kingdom, who fear that the AIFM Proposal would force many AIFMs to "flee" the EU for Switzerland, the United States or certain "offshore" jurisdictions. Paul Hastings is monitoring these developments closely and will keep you informed of key developments.

On June 22, 2009, the European Council adopted the UCITS IV Directive, which covers a number of proposed modifications to the regulation of UCITS (Undertakings for Collective Investment in Transferable Securities). Overall, the UCITS IV Directive does not seek to tamper with the basic principles currently applicable to UCITS, but instead addresses a number of incremental changes and improvements. For a detailed analysis of the UCITS IV Directive, please see here.

## II. TAXATION

On the tax front, the primary developments so far in 2009 have been the following:

- Two proposals by Congress that would likely, if enacted in their current forms, adversely affect the tax positions of hedge funds;
- Interim guidance by the Internal Revenue Service with regard to deferred compensation arrangements for offshore hedge fund managers; and
- Certain tax reporting requirements for investors in and managers of offshore hedge funds.

### *A. Stop Tax Haven Abuse Act*

On March 2, 2009, Senator Carl Levin introduced the "Stop Tax Haven Abuse Act of 2009" (the "Bill"). A companion bill was introduced in the House a day later. The Bill is based on a previous bill (co-sponsored by then-Senator Barack Obama), which failed to gain sufficient support to become law. Treasury Secretary Geithner was quoted as saying that he "fully supports" the current version of the Bill. The Bill contains two important provisions that would directly affect hedge funds and their investors. These provisions would (i) cause certain non-U.S. corporations that are managed and controlled from within the U.S. to be treated as domestic corporations for federal income tax purposes, causing them to become subject to U.S. corporate federal income tax, and (ii) require withholding on payments to non-U.S. persons of dividend equivalent amounts and substitute dividends with respect to the stock of U.S. corporations.

*1. Treating Non-U.S. Corporations as Domestic Corporations*

Under the Bill, a non-U.S. corporation (such as an offshore hedge fund) that is managed and controlled from within the U.S. would be taxed as a domestic corporation if either its stock is regularly traded on an established securities market or if the corporation holds gross assets (including assets that it manages for investors) of at least US$50 million. Currently, a corporation generally must be chartered in a U.S. state to be treated as "domestic."

Under the Bill, if a foreign corporation is publicly traded or meets the asset test, and either (i) the foreign corporation's direct or indirect assets consist primarily of assets being managed on behalf of investors and decisions about how to invest the assets are made in the U.S., or (ii) substantially all the executive officers and senior management who have the day-to-day responsibility for making strategic, financial and operational policies of the corporation are located primarily within the U.S. (which includes any employees who make day-to-day decisions that would normally be made by executive officers or senior management), then the non-U.S. corporation is treated as a U.S. corporation for federal income tax purposes. As a result, the foreign corporation would be subject to federal corporate income tax (and possibly state taxes), and dividends paid to foreign investors will generally be subject to a 30% withholding tax.

This provision would be effective two years after enactment.

*2. Closing of Dividend Withholding Tax "Loophole"*

Under current law, dividends paid by a U.S. corporation to a foreign person are generally subject to a 30% withholding tax (which might be reduced by an applicable tax treaty). However, substitute dividends payments on a notional principal contract, such as an equity swap, are generally not subject to withholding.

The Bill would impose withholding tax on payments of substitute dividends with respect to shares of U.S. corporations. The Bill targets transactions in which a non-U.S. investor owning stock of a U.S. corporation would enter into a notional principal contract or secured lending transaction with a financial institution or hedge fund, pursuant to which the financial institution or hedge fund would make a payment equivalent to the amount of a dividend paid on the stock (often referred to as a "dividend equivalent" or "substitute dividend").

The provision would be effective 90 days after enactment.

The Bill, if adopted, will have a substantial impact on tax planning for hedge funds. Currently, there is no further development on the Bill, and it is uncertain whether the Bill will ultimately be enacted into law.

### *B. Partnership Carried Interests*

The partnership structure of many hedge funds allows fund managers/general partners to receive an "allocation" of the fund's income. Under partnership taxation principles, the allocation is taxed to the fund managers/general partners (and the other investors in the hedge fund) in accordance with the characteristics of that income at the partnership level. In other words, if the income at the partnership level is long-term capital gain, then the income will retain that character in the hands of the fund managers/general partners. Currently, long-term capital gains for individuals are taxed at 15% (as compared to a 35% tax rate for most ordinary income).

On April 2, 2009, Senator Levin introduced a bill (the "Levin Bill") to tax capital gains allocated to a fund manager/general partner holding a partnership "carried interest" as ordinary income. Under the Levin Bill, any income received from a partnership, capital or otherwise, which is deemed compensation for services provided by the fund manager/general partner is subject to ordinary tax rates. Consequently, managers of investment partnerships, such as hedge funds, who receive a carried interest as compensation would have to pay regular income tax rates rather than capital gains rates on that compensation.

Subject to limited exceptions, the Levin Bill would treat allocations with respect to an "investment services partnership interest" made to a partner who directly or indirectly provides a "substantial quantity" of services concerning "specified assets" (generally, securities, real estate held for rental or investment, interests in partnerships, commodities and options or derivatives relating to the foregoing) of the partnership as ordinary income received for the performance of services by the partner. Any such income would be treated as self-employment income, which would therefore be subject to Social Security taxes.

In negotiating limited fund agreements, general partners might want to insert a provision providing them the flexibility to restructure fund arrangements in order to minimize the impact of any future carried interest legislation. However, limited partners in hedge funds tend to be wary of such provisions, unless such new arrangements would not adversely affect their economic interests.

The Obama administration indicated that it supports the carried interest legislation to be effective in 2011. In addition, it has been proposed that the maximum rates applicable to individuals for capital gains would increase from 15% to 20% and for ordinary income from 35% to 39.6%.

### *C. Deferred Compensation*

#### *1. IRS Issues Interim Guidance Under Section 457A*

In January 2009, the Internal Revenue Service (the "Service") issued interim guidance (the "Notice") under Section 457A of the Internal Revenue Code of 1986, as amended ("Code"). Enacted in October 2008, Section 457A of the Code largely eliminates compensation deferrals by nonqualified entities ("NQEs"), and thus any compensation that is deferred under a "nonqualified deferred compensation plan" of a NQE is includible in gross income when the amounts deferred are no longer subject to a "substantial risk of forfeiture." Generally, NQEs are non-U.S. corporations that are not subject to U.S. tax and not subject to foreign income tax or partnerships with substantially all limited partners that are not subject to U.S. tax and not subject to foreign income tax.

*2. "Deferred" Compensation*

Section 457A of the Code states that a payment will be treated as not deferred for Section 457A purposes if made no later than 12 months after the end of the service recipient's (e.g., a hedge fund's) taxable year in which the right to payment vests. The Notice clarifies that only actual payment is required to avoid Section 457A and that the documents do not themselves need to provide that the payment be made. If the 12-month deadline is missed, the deferred amounts (if determinable) will be retroactively included in income for the year when vesting occurred.

Deferred compensation that is not determinable when the right to payment vests is taxable under Section 457A only when the amount does become determinable, but the tax is then increased by 20% of the amount of compensation plus an additional amount in the nature of interest (the "premium interest tax").

For purposes of this rule, the Notice treats amounts as not "determinable" if at the end of the service provider's taxable year the amount of the payment is unknown because it is based on factors that remain variable. Although facts and circumstances will dictate the result in any particular case, the Notice states, as an example, that a deferred fee based on net profits for a given period would be viewed as not "determinable" until the end of that period.

*3. Covered Plan Sponsors*

Most offshore hedge funds will likely be treated as NQEs if they are organized in tax-haven jurisdictions and are classified as corporations for U.S. federal income tax purposes. In general, a corporation will not be an NQE if it is both eligible for the benefits of an income tax treaty between its country of residence and the U.S. (the tax treaties with Bermuda and the Netherlands Antilles do not qualify for this exemption) and is not subject to a beneficial tax regime in its country of residence. This latter requirement may disqualify, among others, certain Irish or Luxembourg corporations.

Section 457A can also apply to plan sponsors that are classified as partnerships for U.S. federal income tax purposes. Under the Notice, in general, a partnership will be an NQE unless at least 80% of its gross income is allocated to persons subject to tax on the income.

The Notice also clarifies that accrual-basis service providers are in fact covered by Section 457A. Although most hedge fund managers operate on a cash basis, managers of other funds (e.g., investment managers owned by corporations) are often accrual-basis taxpayers. Accrual-basis managers may be affected by Section 457A to the extent they do not receive fees on a current basis. Additional information on these developments is available here.

***D. Disclosure Requirements (FBAR)***

Any U.S. person who has a financial interest in, or signature or other comparable authority over, a "financial account" in a foreign country is required to file a report with the Service if the aggregate value of such accounts exceeds US$10,000 at any time during the calendar year.

The filing is made on Form TD F 90-22.1 (Report of Foreign Bank and Financial Accounts or "FBAR"). FBARs covering the 2008 calendar year were due on June 30, 2009 (however, Notice 2009-62 extended the filing deadline from June 30, 2009 to June 30, 2010, for persons (i) with signature or other authority over, but no financial interest in, a foreign financial account, and (ii) persons with a financial interest in, or signature or other authority over, a foreign commingled fund (such as foreign investment entities) for more on this, click here). In general, civil and criminal penalties may be

imposed for failure to file an FBAR, including monetary penalties of up to the greater of 50% of the account value or US$100,000 for willful failures and US$10,000 per account for non-willful failures.

The instructions to the FBAR state that the term "financial account" includes any bank, securities, securities derivatives, or other financial instruments accounts. The instructions go on to state that foreign financial accounts "generally also encompass any accounts in which the assets are held in a commingled fund, and the account owner holds an equity interest in the fund (including mutual funds)." In teleconferences with practitioners, the Service has stated its position that an ownership interest in a hedge fund organized outside the United States is a foreign financial account under this definition. Accordingly, the Service's position is that the FBAR filing requirement applies to U.S. persons who own, or have signature or other comparable authority over, an investment in an offshore fund.

In light of the Service's current position, FBARs should be filed by (i) investment managers that have ownership interests in offshore hedge funds managed by them, (ii) U.S. feeder funds that have ownership interests in offshore master funds, and (iii) U.S. "funds of funds" that own interests in other offshore funds. In addition, FBARs would also need to be filed by individual officers or employees that have signature or other comparable authority over these fund interests. Investment managers may wish to inform shareholders in their offshore funds who are U.S. persons, including U.S. tax-exempt entities, of the FBAR requirements. Additional information on these new requirements is available here.

## III. CIVIL LITIGATION

### *A. Introduction*

On the civil litigation front (and similar to the developments in the enforcement area discussed in part IV below), most 2009 activity has been focused on Ponzi schemes. In *South Cherry Street LLC v. Hennessee Group LLC*,[2] a federal appellate court in New York affirmed the dismissal of an investor's claims against a hedge fund adviser for losses it incurred in the now well-publicized Ponzi scheme involving the Bayou Funds. Click here for additional information on this case. And, in the ongoing post-Madoff imbroglio, investors continued to pursue lawsuits not only against Madoff and his firm, but against various "feeder funds" that invested their clients' funds with Madoff and numerous other categories of defendants. Those cases will test the boundaries of hedge funds' – and their advisers' – liabilities to investors where the underlying investments are claimed to be based on fraud. As Senator Specter recently proposed new legislation that would allow aiding and abetting liability in private civil actions, secondary actors need to be even more mindful of potential fraud claims and the possibility of an expanded liability net.

### *B. Litigation Against Hedge Fund Advisors – Implications of* South Cherry Street *Decision*

On July 14, 2009, the Second Circuit Court of Appeals affirmed the dismissal of contract and securities fraud claims against investment advisers who recommended a hedge fund that turned out to be part of a Ponzi scheme. In that case, the Hennessee Group made a presentation to South Cherry Street, LLC that emphasized its "unique experience and expertise in evaluating hedge funds," including its five-step due diligence process for selecting hedge funds and its ongoing monitoring of investments with the funds. One hedge fund that the Hennessee Group ultimately recommended was the Bayou Accredited Fund – and in 2003-04, South Cherry Street made a total net investment of $1.15 million with Bayou. After the SEC, in a highly publicized 2005 action, charged Bayou and its principals with

securities fraud – a Ponzi scheme that misappropriated millions of dollars from investors – South Cherry Street filed a lawsuit against the Hennessee Group.

The gist of the lawsuit and the appeal, for breach of oral contract and securities fraud, was that Hennessee Group failed to perform any real due diligence on Bayou; if it had, it would have discovered the misrepresentations related to the Bayou principals' experience, their ongoing investment losses, and their lack of a "genuine" auditing firm. The Second Circuit found that South Cherry Street's alleged oral contract based on the presentation in 2001 was void because it was not in writing, could not have been fully performed within a year as New York law required, and was, at bottom, a "unilateral presentation . . . rather than a contract."

More significantly, the Second Circuit also ruled that South Cherry Street's second claim for securities fraud under Section 10(b) of the Securities Exchange Act of 1934, as amended, was correctly dismissed. Under the stringent pleading requirements of the Private Securities Litigation Reform Act of 1995 ("Reform Act"), as reinforced by the U.S. Supreme Court's *Tellabs* decision in 2007, South Cherry Street failed to allege sufficient facts to create a strong inference that Hennessee Group acted with fraudulent intent. To scale the high bar set in *Tellabs*, South Cherry Street had to allege fraud that was "more than merely plausible or reasonable – it must be cogent and at least as compelling as any opposing inference of nonfraudulent intent."

South Cherry Street's complaint was missing several key elements: (i) it did not allege that Hennessee Group participated in the fraud or knew that Bayou's representations were false; (ii) it failed to point to anything that should have alerted Hennessee Group to the issues at Bayou; and (iii) it did not put forth a theory that was as compelling as the competing inference – that Hennessee Group may have been negligent in not digging further. The Second Circuit rejected the motives that South Cherry Street offered for the Hennessee Group's conduct – the desire to reap advisory fees without doing the actual diligence work it promised, or the possibility of some type of "undisclosed payment from the Bayou funds for steering additional investors toward them." Instead, the Court questioned why the Hennessee Group would "deliberately jeopardize" its business and reputation "by recommending to a large segment of its clientele a fund as to which it had made, according to South Cherry, little or no inquiry at all."

What does the *South Cherry Street* decision foreshadow for the ongoing Ponzi scheme litigation involving hedge funds and advisers? The influential Second Circuit court's decision suggests at least two lessons for the future. One, the sheer scope, nature and long life of schemes such as Bayou and Madoff may, in the end, make it difficult for plaintiffs to prevail on a fraud theory against advisers and other secondary players. As the district court in *South Cherry Street* put it, the more compelling explanation in that case was that "the Hennessee Group's failure to discover the fraud merely places it alongside the SEC, the IRS, and every other interested party that reviewed Bayou's finances." Two, hedge funds and advisers should be alert for other theories and claims such as breach of contract and breach of fiduciary duty; note that the plaintiff in *South Cherry Street* did not appeal the dismissal of its breach of fiduciary duty claim, which had also been dismissed by the district court.

### *C. Bernard L. Madoff Investment Securities LLC: Civil Litigation in Its Early Stages*

As has been widely reported, on December 11, 2008, Bernard L. Madoff was arrested for running a decades-long Ponzi scheme that defrauded investors out of billions of dollars, and on March 12, 2009, Madoff pleaded guilty to numerous fraud-related counts, and later was sentenced to 150 years imprisonment.

Inevitably, numerous lawsuits related to these events have been filed in both state and federal courts around the country by or on behalf of various investors against Madoff, his firm Bernard L. Madoff Investment Securities LLC, as well as the various "feeder funds" that invested their clients' funds with Madoff. These actions generally assert fraud and breach of fiduciary type of claims against the defendants. In addition, the claims against the feeder funds also typically allege that those funds failed to manage the investors' money with due diligence and that those funds charged fees that were unjust since the fees were based on inflated net asset value reports of investments with Madoff. All of these actions are still in their early phases.

### *D. Madoff-Related ERISA Litigation*

An interesting and related development that should be closely watched relates to the suits filed on behalf of pension funds asserting violations of the Employee Retirement Income Security Act of 1974, as amended ("ERISA"), arising out of the pension funds' investments in Madoff investment funds. For example, in a class action filed in U.S. District Court for the Eastern District of Pennsylvania, entitled *Pension Fund for Hospital and Health Care Employees – Philadelphia and Vicinity, et al. v. Austin Capital Management Ltd.*,[3] plaintiffs allege that defendant Austin Capital Management breached its duties under ERISA by recommending and investing hundreds of millions of dollars in Madoff-related funds on behalf of the pension funds and their members. In the lawsuit, which has spawned a number of copycat ERISA class actions in other courts, the pension funds contend that, if Austin Capital had properly done its due diligence on the Madoff funds, it would have seen numerous "red flags," including lack of transparency, abnormally "smooth" investment returns, the lack of monthly statements that accurately reflected the returns supposedly being earned, and the like.

These ERISA-based lawsuits add a wrinkle to the Madoff-related litigation. Plaintiffs will argue that the applicable standard of care (that of a "prudent man acting in a like capacity and familiar with such matters") is heightened from the typical fiduciary claim filed against feeder funds and advisers. Unlike claims under the federal securities laws, ERISA suits are not subject to the Reform Act's stringent pleading requirements[4] – although the continued tightening of federal pleading standards generally in recent Supreme Court decisions means that plaintiffs still will not have an easy time in pursuing these suits. And not all hedge funds are regulated by ERISA – only those in which the investments by benefit plan investors are "significant," i.e., at least 25 percent of the value of a class of equity interests issued by the fund. Going forward, the course these ERISA actions take and how the defendants challenge the allegations and defend the substantive claims should be closely monitored.

### *E. More Litigation on the Horizon: Redemption and Distressed Fund Disputes*

Although the financial press has reported recently that hedge fund outflows have begun to abate, given that withdrawals from hedge funds totaled hundreds of billions of dollars both in 2008 and so far in 2009, it is all but inevitable that disputes over redemptions and distressed hedge funds will continue to ripen into litigation during the next six months. The disputes concern not only alleged fraud that comes to light as liquidity decreases and losses mount, but also include valuation disputes and controversies between investors and hedge funds over the timing of redemptions. In many such cases, conflicts have developed after some investors have redeemed and others claim they are left in the lurch once redemptions are suspended. Many of these claims have been litigated offshore, but U.S. litigation also is on the rise.[5] Hedge funds and managers can be expected to challenge these redemption-related lawsuits on the grounds that the suspension of redemptions during times of economic distress is not only permitted by the fund's documents, but is prudent and helps protect the performance of the portfolio for the fund's investors as a whole.[6]

## IV. REGULATORY ENFORCEMENT

### *A. Introduction*

For hedge funds, this year undoubtedly represents the dawn of a new enforcement era. The SEC recently announced that, in the first four months of 2009 alone, it had brought more enforcement actions against hedge funds than in all of 2008 combined.[7] While many of these enforcement actions focused on "traditional" types of fraud, others are breaking new ground as regulators more aggressively examine how hedge funds are managed and marketed in an effort to root out unlawful conduct. Among other issues, the SEC has closely focused on Ponzi schemes, insider trading, and pay-to-play schemes as ways in which unregistered entities such as hedge funds have been involved in violating the federal securities laws. Given the current economic and social climate, hedge funds can expect this trend of increased scrutiny to continue indefinitely. The following summaries of SEC enforcement matters address some key issues that have emerged, along with some lessons learned from each.

### *B. Ponzi Schemes*

In the wake of the Madoff scandal, the SEC has substantially increased the number of cases filed against hedge funds involved in alleged Ponzi schemes. These schemes, which in many instances amassed hundreds of millions of dollars and operated for years without detection, typically involved funds falsely claiming large profits in order to attract further investments to perpetuate the fraud. Other misrepresentations regarding a fund's investment strategy, management structure or targeted investor profile were also commonly employed. Often the perpetrators of Ponzi schemes would never deposit investor funds in investment accounts, but instead would immediately use the funds to pay off prior investors or wrongfully divert the funds for personal use.

In *SEC v. Petters, et al.,*[8] the SEC brought an emergency action against defendants Thomas J. Petters ("Petters"), Gregory M. Bell ("Bell") and Bell's hedge fund management firm, Lancelot Investment Management LLC, seeking, among other things, an asset freeze surrounding an alleged multibillion dollar Ponzi scheme run by Petters. The SEC alleged that, from as early as 1995 through 2008, Petters, a prominent Minnesota businessman, sold notes to investors with the promise that the proceeds would be used to invest in consumer electronics, which in turn would be resold to large retailers. In fact, Petters used the money for his own purposes and repaid purported profits with money from other investors. Bell, through hedge funds he controlled, purportedly acted as a "feeder fund" by investing in the notes Petters sold, and then selling billions of dollars' worth of interests in the same funds to hundreds of other investors. According to the SEC complaint, Bell falsely promised investors that he was taking steps to protect their money and verify the legitimacy of Petters' business, when in reality he took no steps to verify the truth of what Petters told him. Bell also allegedly actively assisted Petters in his Ponzi scheme by concocting "roundtrip" payments between the funds and Petters' company to conceal Petters' delinquent note payments, falsifying monthly statements to investors, and transferring tens of millions of dollars from the hedge funds to accounts Bell and his wife controlled, all without the investors' knowledge.

In another case involving misrepresentations that were especially egregious, *SEC v. Ruderman, et al.*,[9] the SEC successfully obtained a temporary restraining order to halt a hedge fund allegedly engaged in fraud since at least 2002. Specifically, the individual defendant allegedly told investors that the hedge funds under his control were earning annual returns from 15% to 60% per year and had more than $800 million in assets, when in fact the hedge funds had been consistently losing money and only had $650,000 in assets. The defendant also made outlandish statements about current investors: He

falsely claimed that prominent individuals such as Larry Ellison (CEO of Oracle Corporation) and Lowell Milken (Michael Milken's younger brother) were investors in the fund.

Proving that Ponzi schemes can often go unnoticed for years and can target certain communities, in *SEC v. Oversea Chinese Fund Limited Partnership, et al.*,[10] the SEC filed an emergency action to halt an ongoing Ponzi scheme perpetrated by a hedge fund manager dubbed the "Chinese Warren Buffett." The Ponzi scheme involved investments in a Canadian hedge fund that the manager controlled. From 2004 to April 2009, the manager raised between $50 million and $75 million from more than 200 investors primarily from Chinese-American communities. In February 2009, the manager finally confessed that he and the hedge fund had posted false profits on investors' account statements in order to conceal trading losses and attract new investors to the hedge fund.

In order to hide wrongdoing, sometimes the alleged misrepresentations included the creation of fictitious employees, professionals and officers associated with a hedge fund. In *SEC v. Hu et al.,*[11] the SEC alleged that a hedge fund manager with ties to Silicon Valley fraudulently misled investors by falsely claiming that his funds were overseen by attorneys, auditors and other professionals. According to the SEC's complaint, the hedge fund manager also falsely claimed to employ a Chief Financial Officer, forged the CFO's signature in communications with investors, and forged independent audit statements from a "virtual" office he set up for his "independent" auditing firm.

A similar case involving the fabrication of an accounting entity and the suspension of redemptions was *SEC v. Nicholson et al.*,[12] where the SEC charged the defendants with allegedly operating a large-scale hedge fund scheme. According to the SEC's complaint, the defendants misrepresented, among other things, the success record of the funds. In particular, the defendants allegedly misrepresented the value of 11 hedge funds to investors and created a fictitious accounting firm to produce false account statements. Losses were hidden from investors by using false sales brochures, folding assets into other funds, and issuing bad checks. Additionally, some investors were told that redemptions had been suspended due to investors' "irrational behavior."

In a large New York and Connecticut Ponzi scheme case, *SEC v. WG Trading Investors, L.P., et al.*,[13] the SEC successfully obtained an asset freeze and the appointment of a Receiver against various individuals and entities, including a hedge fund, involved in orchestrating a fraud involving the misappropriation of as much as $554 million. The SEC alleged that the scheme had been ongoing since 1996 and involved the solicitation of numerous institutional investors, including $65 million from the University of Pittsburgh. According to the SEC's complaint, the defendants falsely told investors that their money would be invested in an "enhanced equity index" strategy that involved the purchase and sale of equity index futures and equity index arbitrage trading. In fact, investor money was misappropriated for personal use, including the purchase of multimillion-dollar homes, a horse farm and horses, luxury cars, and rare collectibles such as Steiff teddy bears.

Finally, in yet another case where investor monies were used to furnish a lavish lifestyle, the defendants in *SEC v. North Hills, et al.*,[14] were charged with fraud in a "fund of funds" investment scheme. From 2001 to 2007, the fund raised $30 million from 40 to 50 investors through representations that the assets would be invested in a diverse group of hedge funds to ensure diversification and moderate risk. The defendants allegedly sent false monthly account statements that portrayed the investments as profitable, when in reality the investments were being used in part so the defendant could make "loans" to himself. These loans included more than $13.2 million of investor funds used to purchase luxury homes, cars, and boats.

With the Madoff saga still a regular news item and public outrage remaining high, Ponzi schemes will undoubtedly remain a favorite target of SEC enforcement actions. Not only will these actions continue to directly implicate hedge funds themselves, they will likely target deep-pocket secondary actors as well. Auditors, lawyers, administrators and other service providers need to be vigilant when signs of potential fraud appear as more and more expansive litigation against secondary actors is being brought and Congress has recently introduced legislation to hold them accountable under aiding and abetting liability.[15]

### *C. Insider Trading*

In testimony before the United States House of Representatives Committee on Financial Services, SEC Commissioner Elisse B. Walter stated that the SEC had formed a Hedge Fund Working Group to address various concerns involving hedge funds, including market manipulation and insider trading.[16] According to Commissioner Walter, among the initiatives of the Hedge Fund Working Group is to develop "technological tools that will enable the staff to more readily capture patterns of unlawful trading by hedge funds and institutional traders." It should be no surprise then that the SEC has been regularly filing insider trading actions and taking aggressive positions in court that would extend the contours of insider trading law.

In a recent opinion with far-reaching implications, the Second Circuit in *SEC v. Dorozhko*[17] ruled that a defendant could be held liable for insider trading even if he did not violate any fiduciary duty in obtaining the material non-public information upon which he traded. The defendant in this case was allegedly a computer hacker who was able to access material, non-public information regarding a company's earnings. Within an hour of obtaining this information, the defendant purchased $42,000 of the company's put options, on the theory that the value of the company's stock would drop in price. Later that day, the company announced that its earnings had come in significantly below analysts' expectations. The price of the stock subsequently plummeted, and the defendant sold his put options later that day for a profit of approximately $286,000.

The defendant argued that he could not be held liable for insider trading under Section 10(b) of the Securities Exchange Act of 1934 and SEC Rule 10b-5 because, since he did not owe anyone a fiduciary duty, his conduct could not be considered "deceptive" within the meaning of Section 10(b). The District Court agreed, but the Second Circuit vacated the District Court order, rejecting its conclusion that actionable deception under Section 10(b) required a breach of fiduciary duty. The Court held that the fiduciary duty requirement only applied in the context of omissions, and in the case of affirmative representations, no such duty was necessary. The Second Circuit remanded the case to allow the District Court to determine whether the hacker had engaged in false identification by representing himself as an authorized user, which would be plainly deceptive, or had simply exploited a weakness within the computer system to gain access, which might be "mere theft."

In what is believed to be one of the first insider trading cases involving credit default swaps ("CDS"), *SEC v. Rorech, et al.*,[18] the SEC charged a hedge fund manager with participating in an insider trading case involving CDS. The complaint alleged that Jon-Paul Rorech ("Rorech"), a bond trader and credit default swap salesman, became aware of non-public information regarding the restructuring of an upcoming bond issuance. Rorech allegedly passed this information along to Renato Negrin ("Negrin"), who was portfolio manager and hedge fund investment adviser at another company. Negrin, on behalf of a hedge fund advised by his company, allegedly purchased CDSs covering the bonds based on this inside information. Once the announcement of the bond restructuring was made public, Negrin closed his CDS position for a profit of approximately $1.2 million. The evidence of insider trading included

recorded telephone conversations between Rorech and Negrin that referred to the bond restructuring, followed immediately by unrecorded conversations on their cell phones. In noting that, "[a]lthough CDS market participants tend to be experienced professionals, there must be a level playing field," the SEC signaled its intent to pursue insider trading cases even where the alleged misconduct concerns sophisticated financial instruments and counterparties and does not impact the average investor.

Finally, in *SEC v. Tajyar et al.*,[19] a former account executive of an investor relations firm was charged with insider trading for repeatedly misappropriating confidential information from firm clients, and for tipping his current employer and former colleague who traded on the information and informed others. The account executive routinely learned information about his employer's clients before the information was released to the public. That information was passed along to a co-defendant, who used the information to trade in his own accounts and in a hedge fund he managed. As alleged in the Commission's complaint, the defendants realized more than $1.4 million in total profits from the insider trading.

Overall, the SEC is taking a more aggressive stance with regard to trading violations. In light of *Dorozhko*, we can expect a more expansive interpretation of securities violations outside the normal classic or misappropriation theories. Moreover, the SEC is increasing its resources and capabilities so it can better uncover and prosecute patterns of unlawful trading. In this regard, the new Enforcement Director recently announced the formation of specialty enforcement units, one of which will be designed to quickly target abusive trading practices.[20]

### *D. Kickbacks / Pay to Play*

A number of recent pay-to-play scandals have hit the hedge fund world, some involving government corruption. These cases have highlighted an area of inquiry that appears to be a primary focus of the SEC, as well as other regulators and prosecutors. For instance, the SEC on July 22, 2009 announced a proposal to "curtail 'pay to play' practices by investment advisers that seek to manage money for state and local governments" (see more above).[21]

In *SEC v. Morris et al.,*[22] a hedge fund manager allegedly took part in a scheme to extract kickbacks from investment management firms seeking to manage assets of New York's largest retirement fund. In particular, the New York State Deputy Comptroller allegedly caused the retirement fund to invest billions with investment management firms that in turn allegedly agreed to pay millions to the defendants, including the hedge fund manager, in the form of "placement agent" fees. According to the regulators and prosecutors, these fees were nothing more than kickbacks that were *quid pro quo* for the lucrative investment management contracts rewarded to the investment manager firms who made the illegal payments. To avoid detection of their scheme, the defendants would direct the kickback payments to be made to offshore entities.

In another case, *SEC v. Travis, et al.,*[23] the SEC alleged that illegal payments ranged from international vacations to the building of a special crate for a Great Dane. According to the SEC's complaint, two brokers and a broker-dealer associated with one of the brokers allegedly paid bribes to two employees of a hedge fund adviser, in exchange for the employees routing hedge fund trades to the brokers and the broker-dealer. Bribes took the form of expensive vacations, hotels, rent payments and car service, and totaled more than $312,000, while the brokers received commissions in excess of $10 million from trades directed to them. The employees concealed their bribery scheme, and the material conflicts of interest it created, by using a "net" commission structure to obscure the amount of trades and the associated commissions they were directing to the brokers.

Whether political or not, kickback and pay-to-play fee arrangements are vigorously being pursued by the SEC. Fee arrangements and commissions of any sort should be closely evaluated to ensure they do not run afoul of existing SEC regulations, and procedural safeguards should be established within hedge funds to ensure that conflicts of interest do not unnecessarily occur.

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*If you have any questions concerning these developing issues, please do not hesitate to contact any of the following Paul Hastings lawyers:*

*Hedge Fund Regulatory and Tax*

**London**

Christian Parker
44-20-3023-5161
christianparker@paulhastings.com

**Los Angeles**

Arthur L. Zwickel
213-683-6161
artzwickel@paulhastings.com

**New York**

Domenick Pugliese
212-318-6295
domenickpugliese@paulhastings.com

Michael R. Rosella
212-318-6800
mikerosella@paulhastings.com

**Palo Alto**

Thomas S. Wisialowski
650-320-1820
thomaswisialowski@paulhastings.com

Friedemann Thomma
650-320-1879
friedemannthomma@paulhastings.com

**San Francisco**

David A. Hearth
415-856-7007
davidhearth@paulhastings.com

Mitchell E. Nichter
415-856-7009
mitchellnichter@paulhastings.com

Gregory S. Zeck
415-856-7016
gregoryzeck@paulhastings.com

*Hedge Fund Litigation and Enforcement*

**Los Angeles**

William F. Sullivan
213-683-6252
williamsullivan@paulhastings.com

Howard M. Privette II
213-683-6229
howardprivette@paulhastings.com

Thomas A. Zaccaro
213-683-6285
thomaszaccaro@paulhastings.com

**New York**

Kenneth M. Breen
917-215-8639
kennethbreen@paulhasings.com

Keith W. Miller
212-318-6005
keithmiller@paulhastings.com

Barry G. Sher
212-318-6085
barrysher@paulhastings.com

**Palo Alto**

Peter M. Stone
650-320-1843
peterstone@paulhastings.com

**San Diego**

Christopher H. McGrath
858-458-3027
chrismcgrath@paulhastings.com

**San Francisco**

John A. Reding
415-856-7004
jackreding@paulhastings.com

Grace A. Carter
415-856-7015
gracecarter@paulhastings.com

Edward Han
415-856-7013
edwardhan@paulhastings.com

**Washington, D.C.**

James D. Wareham
202-551-1728
jameswareham@paulhastings.com

[1] This was one piece of the "Derivatives Markets Transparency and Accountability Act of 2009," which was circulated through the House Agricultural Committee in January of this year.

[2] 2009 WL 2032133 (2d Cir. July 14, 2009).

[3] Case No. 2:09-cv-00615 PBT (E.D. Pa., filed February 12, 2009).

[4] When hedge fund investments decline, investors frequently file class actions against a variety of defendants under the federal securities laws in an effort to recover for their losses. Courts have often dismissed such complaints because the allegations fall short of the specificity required under the Reform Act. For an example, see *MJX Plus LLC v. Citigroup Inc.*, Case No. 08-civ-10931 (S.D.N.Y., August 10, 2009) (dismissing complaint against Citigroup for inducing plaintiff investors to invest $50 million in the Falcon fund based on alleged misrepresentations about the low risk, liquid investment portfolio in the fund and its strategy of minimizing risk by following strict risk management guidelines).

[5] A recent example of these disputes is found in the complaint in *Palmetto Partners, L.P., and Steven Mizel Roth IRA v. AJW Qualified Partners, LLC, AJW Manager, LLC, and Corey S. Ribotsky, Supreme Court of the State of New York, Nassau County* (filed March 2009).

[6] Defendants' motion to dismiss in the *Palmetto Partners'* case, filed in May 2009, makes this type of prudence argument.

[7] SEC Release No. 2009-102, SEC Charges Hedge Fund Manager and Bond Salesman in First Insider Trading Case Involving Credit Default Swaps (May 5, 2009), http://www.sec.gov/news/press/2009/2009-102.htm.

[8] No. 09-SC-1750 (D. Minn. July 7, 2009); *see also* SEC Litig. Release No. 21124 (July 10, 2009), http://www.sec.gov/litigation/litreleases/2009/lr21124.htm.

[9] No. CV-09-02974 VBF (C.D. Cal. Apr. 28, 2009); *see also* SEC Litig. Release No. 21017 (Apr. 28, 2009), http://www.sec.gov/litigation/litreleases/2009/lr21017.htm.

[10] No. 3-09-CV0614-B (N.D. Tex. Apr. 3, 2009); *see also* SEC Litig. Release No. 20988 (Apr. 6, 2009), http://www.sec.gov/litigation/litreleases/2009/lr20988.htm.

[11] No. C-09-01177 RMW (N.D. Cal. Mar. 18, 2009); *see also* SEC Litig. Release No. 20962 (Mar. 18, 2009), http://www.sec.gov/litigation/litreleases/2009/lr20962a.htm.

[12] No. 09-CIV-1748 (S.D.N.Y. Feb. 25, 2009); *see also* SEC Litig. Release No. 20911 (Feb. 25, 2009), http://www.sec.gov/litigation/litreleases/2009/lr20911.htm.

[13] *See* WG Trading Investors, L.P., et al. (July 6, 2009), http://www.sec.gov/divisions/enforce/claims/wgtrading.htm; *see also* SEC. Litig. Release No. 20912 (Feb. 25, 2009), http://www.sec.gov/litigation/litreleases/2009/lr20912.htm; 09-CIV-1750 (S.D.N.Y. Feb. 25, 2009).

[14] SEC Litig. Release No. 20913 (Feb. 25, 2009), http://www.sec.gov/litigation/litreleases/2009/lr20913.htm.

[15] *See* Joshua Gallu, *Specter Law Would Let Investors Sue Fraud Accomplices*, Bloomberg News, Aug. 4, 2009, available at http://www.bloomberg.com/apps/news?pid=20601103&sid=aez.SQHDhS0E.

[16] Elisse B. Walter, Commissioner, SEC, Testimony Before the United States House of Representatives Committee on Financial Services (Mar. 20, 2009), http://www.sec.gov/news/testimony/2009/ts032009ebw.htm.

[17] 08-0201-cv, 2009 U.S. App. LEXIS 16057 (2d Cir. Jul. 22, 2009).

[18] 09-CIV-4329 (S.D.N.Y. May 5, 2009); *see also* SEC Litig. Release No. 21023 (May 5, 2009).

[19] No. CV 09-03988 SJO (C.D. Cal. Jun. 4, 2009); *see also* SEC Litig. Release No. 21069 (Jun. 4, 2009), http://www.sec.gov/litigation/litreleases/2009/lr21069.htm.

[20] *See* Joshua Gallu and David Scheer, *SEC Forms Enforcement Units, Widens Subpoena Power*, Bloomberg News, Aug. 5, 2009, available at http://www.bloomberg.com/apps/news?pid=20601087&sid=ahBE4km.CTq8.

[21] SEC Release No. 2009-168, SEC Proposes Measures to Curtail "Pay to Play" Practices (July 22, 2009), http://www.sec.gov/news/press/2009/2009-168.htm.

[22] No. 09-CIV-2518 (CM) (Apr. 15, 2009); *see also* SEC Litig. Release No. 21101 (Apr. 15, 2009), http://www.sec.gov/litigation/litreleases/2009/lr21001.htm.

[23] No. 09-CIV-2288 (Mar. 12, 2009); *see also* SEC Litig. Release No. 20948 (Mar. 12, 2009), http://www.sec.gov/litigation/litreleases/2009/lr20948.htm.