

CAPITOL ACCOUNT

A New Plan to Fight Back Against SEC Overreach - From Agency Alumni

Also, analysis of China audit deal; a crypto lobbyist pushes FDIC on deposit insurance warning

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In April, **Elon Musk** and **Mark Cuban** took the unusual step of banding together to weigh in at the Supreme Court. They wanted the justices to take up a case challenging a much-debated SEC policy: those settling enforcement actions must neither admit nor deny the allegations. The two executives have, of course, had their own run-ins with the SEC's securities cops – experiences that turned them into some of the regulator's most prominent foes. Joining Musk and Cuban in filing an amicus brief were two lesser known (though just as vociferous) agency opponents: **Phil Goldstein**, who successfully sued years ago to block a hedge-fund registration rule, and **Nelson Obus**, who fought commission insider trading charges for more than a decade and was exonerated after a jury trial.

The four argued that the SEC was violating defendants' First Amendment rights by essentially imposing gag orders that bar them from discussing the facts of cases. Though it was ultimately part of a losing effort (the high court declined to take the case a couple of months later), the critics' decision to join forces captivated the securities bar. Some see it as akin to one of those James Bond villain meetings, or perhaps the teaming up of the Penguin, Riddler, Catwoman and the Joker – with a mission of going after the regulator.

How did it happen? Not by coincidence.

The story behind the Supreme Court brief begins with an organization called the Investor Choice Advocates Network, which was recently formed by alumni of the SEC's enforcement unit who

now work in private law practice. They tell *Capitol Account* that despite the innocuous name, they plan to use the group to shine a spotlight on what they see as SEC overreach – partly by weighing in on important appellate cases, but also by offering free legal services to defendants caught up in investigations. A number of those probes could be in the cryptocurrency area where the SEC has been busy.

ICAN is the brainchild of **Nick Morgan**, a partner at Paul Hastings in Los Angeles. The idea was spurred, he says, by watching numerous people being railroaded into settling cases with the SEC rather than taking them to court where they had a decent shot at winning. For those of limited financial means, and no company or insurance firm picking up the tab, there's really no choice, he says.

“We saw the SEC bring a lot of bad cases, so I think the number of people we could help is quite large,” Morgan says.



Nick Morgan

Of course, Musk and Cuban do have the means to fight the SEC. And Cuban, at least, tapped his fortune to pay \$12 million in legal fees to beat back a 2008 enforcement action that accused him of selling stock based on inside information. Morgan notes that both jumped at the chance to get on his brief. All it took was a call or two to mutual connections.

But big law firms, Morgan says, often won't represent entrepreneurs who can't afford to pay their high rates. And pro bono work is more frequently directed at non-business matters like helping veterans, indigent criminal defendants or death row inmates. Budding financial professionals? Not so much.

Looking to fill that gap, Morgan and his fellow Paul Hastings partner **Thomas Zaccaro**, also a former SEC trial attorney, incorporated ICAN in late 2021. In the spring, they received their not-for-profit designation from the IRS. Now, the two are working to raise enough funds so that they can hire staff and start identifying a handful of cases each year where they think the chances of winning are strong.

Morgan says that he respects the SEC, where he spent seven years litigating enforcement cases before moving on to private practice. In almost two decades of defense work, however, he's come to see first hand the government's power – and its basically unlimited time and money to pursue cases.

SEC settlements can become a vicious circle of sorts, Morgan says, where the agency's pushing of the boundaries is rarely tested. But they nonetheless become a legal foundation for future cases that also push the limits.

Morgan was inspired to start ICAN partly because of a case he's been involved with – a 2015 SEC enforcement action against Pacific West Capital Group. The Los Angeles-based firm sold insurance products called life settlements, where investors buy up policies, cash out the owners and then honor the premium payments. When the original policyholders die, the investors keep the death benefits. The SEC alleged that Pacific West concealed that it was using new money raised from investors to pay premiums on life settlement contracts sold years earlier.

The agency also filed charges against three former Pacific West sales agents, Morgan's clients, who were drawn into the case because the agency contends they were selling unregistered securities (this may sound familiar to the crypto crowd). Morgan argues that the allegations are way out of line. And while some of his clients made large commissions on the products, they certainly weren't the masterminds of the operation. Even the SEC, in its investigation, conceded that Pacific West hid its misconduct from them, he says. Morgan is handling the case pro bono.

“These are not Rockefellers,” Morgan says. “Our clients held these jobs years ago and now the SEC wants them to pay a bunch of money in penalties – basically all the money they earned.”

Morgan sees similar issues already cropping up in the crypto space. He worries that the agency will secure a number of settlements against defendants who have been accused of selling digital

tokens – arguing that they should have been registered with the agency. And little of that will get tested in court.

“When you get a bunch of settled cases – a slow accumulation of a body of law – what is the impact?” Morgan asks. “In our view, it dissuades newcomers from entering the financial markets and hurts innovation. Crypto was not the reason why we started ICAN, but it is very much an area where the ICAN model would apply.”

Right now, ICAN is focusing on what Morgan calls low-cost advocacy – filing amicus briefs and submitting comment letters to regulators. It has secured a grant and is on a path to being able to take on a case or two in the coming months. Going forward, Morgan hopes ICAN has the means to represent clients itself and prep litigation that can be handled in coordination with big law firms.

Among the early financial backers is Goldstein, who was on the Supreme Court amicus brief (Goldstein declined to say how much he donated, but Morgan calls his contribution modest). The hedge fund manager was eager to help.

“The SEC needs to be reined in,” Goldstein says. “It’s doing things that I would call illegal and unconstitutional.”

Morgan hasn’t hit Musk or Cuban up for a contribution. But considering how easy it was to get them to sign ICAN’s Supreme Court brief, maybe he should try. It’s not like they don’t have the funds – or the motivation.