

## SEC GOES GLOBAL, AGAIN

By **Brian Neil Hoffman**

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The [U.S. Securities and Exchange Commission](#) recently sued four Mexican citizens residing in Mexico, who worked at a Mexican company located in Mexico and listed on the Mexican Stock Exchange. The suit alleges that the individuals were involved in an accounting fraud involving homebuilding projects largely located in Mexico and in a fraud involving Mexican banks. The company's American depository shares (ADS) were listed on the New York Stock Exchange, and the company made periodic filings with the SEC, but there appear to be limited other ties to the U.S.

The SEC announced its case against the company, [Desarrolladora Homex SAB](#) de CV, earlier this year. The SEC claimed that the company had overstated its revenues by \$3.3 billion during a three-year period. The SEC alleged that the company inflated the numbers of homes that it built and sold by over 100,000 homes. Fascinatingly, the SEC used satellite imagery to view the homebuilding sites at issue. Some images are in the SEC's release and complaint. The SEC alleged that the images show bare dirt instead of finished homes. The SEC also alleged that the company monetized its fictitious accounts receivables from the fake home sales by entering into factoring agreements with multiple Mexican banks, using the loan proceeds from one arrangement to pay off another.

The company settled without admitting or denying the SEC's charges and agreed to a permanent injunction and a five-year ban on offering securities in the U.S. The SEC's release noted that the company had filed for the Mexican equivalent of bankruptcy, undertaken "significant remedial efforts," and "cooperated with the SEC's investigation."

Now, the SEC announced that it has filed charges against the four executives who allegedly "masterminded" the financial fraud: the company's then-CEO, then-chief financial officer, then-controller and a then-manager in the company's operations department. They allegedly hid the scheme from the company's auditors and others by creating a second set of false books. Certain of the charged individuals signed the factoring agreements and certified the company's SEC filings. The SEC's complaint filed in U.S. district court seeks permanent injunctions, disgorgement, civil penalties, and officer and director bars. The individuals are currently litigating the SEC's lawsuit.

### Continued Global Enforcement

This case again demonstrates the global reach of the SEC in enforcing the U.S. federal securities laws. The SEC has not been shy about enforcing the Foreign Corrupt Practices Act against foreign companies, as discussed in this article. This case makes clear that the SEC will not hesitate to enforce other provisions of the federal securities laws against foreign companies — and their executives — as well.

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In brief, foreign companies directly listed on U.S. exchanges are “issuers” subject to the federal securities laws — like the homebuilding company discussed above. Foreign companies also may be deemed “issuers” when their ADSs are sponsored — that is, the foreign company is involved with a U.S. bank that issues the ADSs, and the company must file with the SEC — and they are listed on a U.S. exchange. (For simplicity, I use the terms ADSs and American depository receipts interchangeably.) Plus, companies with sponsored ADSs that are not listed on an exchange but trade on the over-the-counter markets (called Level I ADSs) likewise could be forced to defend claims alleging violations of the U.S. securities laws.

Put simply, foreign companies — and their individual executives, even foreign nationals — that access the U.S. capital markets should prepare themselves for potential involvement by the SEC’s Division of Enforcement if issues were to arise.

Moreover, the SEC’s global enforcement often occurs in conjunction with other international regulatory agencies. For example, the SEC’s release in the above-discussed homebuilding case thanks the Mexican Comisión Nacional Bancaria y de Valores — a Mexican financial regulatory agency — for its assistance. And in another recent case, the SEC acknowledged the assistance of regulators in 13 different countries outside of the U.S.

### Tips to Help Minimize Risks of SEC Enforcement

Whether domestic or foreign-based, companies subject, or potentially subject, to the SEC’s jurisdiction can proactively take steps that help minimize their enforcement risks.

- 1. Proactive Compliance Measures Help.** Ensuring that the company has comprehensive policies, procedures and controls focused on compliance with the U.S. securities laws provides critical safeguards that may help avoid or minimize a potential enforcement issue. Written compliance programs should be supplemented with regular training and executive attention so that all aspects of the company — around the U.S. or the world — operate with a culture of compliance/ethics. In the event that issues do arise, upfront compliance efforts may help reduce potential sanctions. Indeed, regulators have high expectations in this regard, and they have not hesitated to charge companies that implemented ineffectual efforts.
- 2. Encourage Internal Whistleblowing and Don’t Retaliate.** Companies and their personnel can most efficiently identify and appropriately remediate potential concerns. Entities should encourage concerned employees to first report issues through internal whistleblower avenues. Note that the SEC heavily incentivizes reports directly to the agency: whistleblowers who provide information that leads to a successful enforcement action involving sanctions of over \$1 million may receive an award of 10 to 30 percent of the amount collected by the SEC. Yet companies that encourage and appropriately respond to internal whistleblower reports (see next point) may see fewer employees bypass internal reporting avenues for these SEC incentives. When reports are received, companies should ensure that no retaliatory actions are taken against the individual. The government has aggressively pursued companies that are deemed to retaliate against, or otherwise impede, whistleblowing (for example, see this [prior article](#)).

3. ***Appropriately Investigate and Address Potential Red Flags.*** Self-discovery of potential red flags, promptly followed by appropriate investigation and remediation, may yield benefits with the SEC, not to mention the benefits to the company and shareholders. Given the proliferation of potential risks, companies are well advised to engage counsel to conduct an efficient, cost-effective and reliable investigation of potential issues.
4. ***Consider Self-Reporting.*** The government touts the benefits of self-reporting issues. Yet no one size fits all here. Companies and their counsel should analyze the facts and circumstances of each matter to determine whether self-reporting is appropriate.
5. ***Consider Individual Counsel.*** Individuals may face personal exposure for securities violations, so consider individual counsel early. The homebuilder case discussed in this article underscores that few, if any, employees — even foreign-based personnel — are immune from potential enforcement action.
6. ***Update and Upgrade Insurance Coverage.*** Not all insurance policies provide coverage for internal investigations or for pre-charging investigations by the SEC or other agencies. Entities and their personnel should review existing policies to ensure satisfactory coverage, particularly if individuals may seek their own counsel.

Access to the U.S. capital markets provides numerous benefits to companies, both domestic and foreign. Companies seeking these benefits should promptly take steps to address the accompanying potential enforcement risks — to protect both the entity and its personnel.

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