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SEC Developments: Strong Enforcement Wake Ahead

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Turning a battleship even slightly creates a large wake, not unlike the enforcement waters that have been churning recently at the Securities and Exchange Commission (SEC). The new agency head, Gary Gensler, was formerly an aggressive enforcer as chair of the Commodity Futures Trading Commission (CFTC). Even prior to his arrival, with a series of legislative, court and agency decisions (perhaps less visible during the sea fog of the 2020 election and fallout), the SEC is being redirected for intensified enforcement campaigns on a number of fronts and private litigation may follow. At least seven possible waves may result and we will review them in this alert.

1. New Disclosure Rules

Chairman-designate Gensler testified at his March 2, 2021 confirmation hearing on several new areas of focus. Principal is the emphasis on new disclosure rules, which might require companies to report more about political contributions, workforce diversity, corporate governance, and the risks of climate change. Then, on March 4, 2021, the SEC created a Climate and ESG Task Force in the Division of Enforcement. Another new focus would be on trading apps, like Robinhood, regarding whether investors get the best deals when such apps sell their trades for execution by market-making firms. Whereas former Chairman Jay Clayton emphasized cybersecurity issues and protecting retail investors under his Main Street investor initiative, more emphasis may now be placed on public companies (and possibly private equity and hedge funds, *e.g.*, conflicts of interest) and issues such as inadequate disclosures, revenue recognition, and improper accounting.

2. Authorizing Formal Orders of Investigations

Interim Commission leadership has recently restored the power of senior officers in the Division of Enforcement to authorize a formal order of investigation without recourse to the Commissioners. This will expedite issuance of document subpoenas and taking testimony. Moreover, waivers in settlement offers from disqualifications stemming from securities violations will no longer be recommended for approval by the Division of Enforcement to the Commission. Rather, the SEC's Division of Corporation Finance and Investment Management will review such waiver requests in a "separate and distinct" process.

3. Relief Issues

Relief issues will still persist, especially regarding disgorgement. *Koresh v. SEC,* 137 S. Ct. 135 (2017) and *Liu v. Sec. & Exch. Comm'n*, 140 S. Ct. 193 (2020) subjected the SEC's remedy of disgorgement to its statute of limitations and narrowed what the calculation could be to net profits to be paid to victims. On January 1, 2021, the Congress overrode the President's veto and enacted the National Defense Authorization Act for fiscal year 2021. It extended the statute of limitations for disgorgement from five years to ten years for violations requiring scienter (and set ten years as the statute of limitations for any equitable remedy). How the victims can be identified so as to return funds (a "restitution" concept) under the new law may remain an issue, as well as whether they are in fact the proper recipients of the funds, since "disgorgement" focuses on unjust gains, not victim losses.

4. DPAs and NPAs

The SEC's use of deferred prosecution agreements (DPAs) and non-prosecution agreements (NPAs) may be tested further under the new administration and its projected reinvigoration of enforcement. Beginning with the first individual DPA in 2013 (*SEC v. Scott Herchis*), and continuing through the 2020 mammoth DOJ-SEC joint

agreements with Boeing and Wells-Fargo, the option to defer or forego agency prosecution of its civil claims has been sporadically invoked.

5. COVID-19 and Private Securities Litigation

As especially encouraged by the marketplace uncertainties imposed by COVID-19, private securities "event driven" litigation has proliferated. The continuing focus in this type of private securities litigation since March 2020 has been on allegations that issuers understated the pandemic's impact on their business or concealed/delayed reporting workplace outbreaks of the virus. In January 2021, the first dismissal of such allegations occurred in *Berg v. Velocity Fin., Inc.*, No. 2:20-CV-06780-RGK-PLA, 2021 WL 268250 (C.D. CA. Jan. 25, 2021). The district court found that the allegations were not based on information available at the time of the real estate lender's IPO or were in fact contradicted in the offering materials. Finding there had been proper cautioning in the materials in any event, the court held that the issuer could not have anticipated the pandemic's extent or the rate of increase of non-performing loans when filing the January 2020 offering. Yet, as the pandemic came to be recognized, subsequent issuer filings may not escape scrutiny, including by the SEC. The SEC in its first case charging a public company with misleading investors about COVID-19's impact on its financials came on December 4, 2020 in settled charges against The Cheesecake Factory. Industries such as travel (*e.g.*, cruise lines), health care, software, energy, and financial services, as well as others, have been thrown into the waters of private class actions and possible SEC enforcement actions.

6. Disclosure Requirements and Safe Harbor

In the wake of COVID-19-specific SEC pronouncements in March 2020 and thereafter about disclosure requirements and safe harbors for appropriate forward-looking statements, both SEC enforcement and private class actions can be anticipated. Recent court guidance as to the broad protection of statements about future projections and plans may offer some comfort. In *Wochos v. Tesla, Inc.,* 985 F.3d 1180 (9th Cir. 2021), the court affirmed the safe harbor for such forward-looking statements under the Private Securities Litigation Reform Act. Specifically, said the court, while the statements may have "non-forward looking features" embedded, they may be protected only as ways of stating the objective or plan which "necessarily reflects an implicit assertion that the goal is achievable based on current circumstances." The exception is where the future objective is based on "a concrete factual assertion about a specific present or past circumstance."

7. Whistleblower Complaints

Renewed attention to whistleblower complaints (and their inducements) lodged with the SEC may spur more enforcement. A recent more than $9.2 million award to a whistleblower underscores incentives for insiders or disgruntled current and former employees to come forward. In fiscal year 2020, a total of $175 million went to 39 whistleblowers. A December 2020 award to a whistleblower employee with audit/compliance duties – the fourth such instance – also reinforces the SEC's use of the program to enhance its efforts. In addition, use of compliance sweeps and intensified data analysis (*e.g.*, insider trading identification) will continue to assist the SEC to hoist its enforcement flag.

While these seven waves may reflect merely some of those visible on the horizon, it is clear that the good ship SEC (with an assist from the private bar) is churning the enforcement waters. If you have any questions, please contact the authors or your Baker Donelson attorney.