

# PUBLICATION

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## SEC Enforcement Developments: Fessing Up and Paying Up

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**As the SEC has recently completed its fiscal year on September 30, 2021, where it pushed its enforcement initiatives under new Chairman Gary Gensler, a brief overview of its recent track record is in order. No one can now doubt the enhanced enforcement already underway in the Biden Administration. Basically, the SEC mantra is "fess up" and "pay up."**

### **No More Settlements Without Admitting Wrongdoing**

On October 13, 2021, the SEC Director of Enforcement, Gurbir Grewal, announced a change in SEC policy about settling investigations and cases. Except for a few prominent instances in the Obama Administration, under Director Mary Jo White, companies and individuals have been able to settle investigations and actions without admitting or denying the allegations. Now companies must admit to wrongdoing when resolving civil enforcement matters. As usual, fraud cases are referred to the Department of Justice for criminal prosecutions. While the SEC hopes this more stringent settlement policy will encourage companies to stop and report misconduct, as a practical matter it will encourage plaintiffs to more aggressively pursue private litigation since they can use the settling companies' "confessions" as proof of the violations – which could disincentivize companies from self-reporting or from quickly settling with the SEC.

### **Enforcement of Insider Trading and Misrepresentations Takes on New Theories as Well as Possible Regulation**

In two new cases the SEC recently expanded its reach against insider trading and misrepresentations. In a first, on August 17, 2021, the SEC charged a pharmaceutical executive with insider trading while possessing confidential information of another separate but "economically linked" company in the same market under a theory of "shadow trading." *SEC v. Panuwat*, Case No. 4:21-cv-06322 (N.D. CA.). In another first, on September 14, 2021, the SEC settled an enforcement action charging an alternative data provider with misrepresentations both to its data sources and to investment firms for its concealed use of non-aggregated/non-anonymized data. A \$10 million penalty was imposed, and the former CEO was fined and barred. *In the Matter of App Annie, Inc., et al.*, SEC Administrative File No. 3-20549. Finally, as reemphasized in Chairman Gensler's September 14, 2021 Senate testimony, tightening Rule 10b5-1 plan trading by company insiders will be a focus.

### **Company Treatment of Social Issues, Such as Race and Gender, is Subject to Investigation**

On September 21, 2021, Activision Blizzard, Inc. disclosed the SEC had subpoenaed current and former employees, including its CEO. The focus is what company leaders knew about allegations of sexual harassment and gender discrimination and possibly misleading disclosures by the company and its executives. The company also faces a July 2021 lawsuit by California over its workplace culture, leading to the resignation of the company's president. This type of initiative was also emphasized in Chairman Gensler's testimony.

### **Cybersecurity Disclosures are Now Front-and-Center for Enforcement Actions**

While the SEC Enforcement Division Cyber Unit is not new, on August 30, 2021, the agency settled enforcement actions against eight investment advisors and broker-dealers which, although having cybersecurity policies in place, sustained breaches that exposed clients' personal identifiable information (PII). Moreover, instances of public companies making misleading disclosures about breaches are also being pursued. This SEC effort is also backed up by the Department of Justice's October 6, 2021 announcement of

its new Civil Cyber-Fraud Initiative to seek False Claims Act enforcement against government contractors and grant recipients who:

1. provide deficient cybersecurity products or services,
2. misrepresent their own cybersecurity practices or policies, or
3. knowingly fail to monitor and report instances or breaches of cybersecurity.

### **Prosecuting Misleading COVID-19 Disclosures Continues**

On July 7, 2021, the SEC charged Parallax Health Sciences, Inc., Case No. 1:21-cv-05812 (S.D.N.Y.), with making misleading statements through press releases touting the availability "soon" of a COVID-19 screening test and the availability of PPE for "immediate sale." The SEC alleged that the company's insolvency prevented developing the test and that it never had the medical and PPE equipment it claimed. This effort continues the enforcement focus first undertaken in the December 2020 settlement (with a \$125,000 fine) with The Cheesecake Factory for falsely claiming that its restaurants were "operating sustainably" despite COVID-19. *In the Matter of The Cheesecake Factory, Inc.*, SEC Adm. Proc. File No. 3-20158 (Dec. 20, 2020).

### **Climate Change Disclosures Must Be Strengthened**

While also a part of SEC Chairman Gensler's recent testimony, the issue of how climate change disclosures are made has intensified since the agency's 2010 Climate Change Guidance (Release No. 33-9106, Feb. 2, 2010) was issued. Specifically, companies must state:

4. the impact of climate change legislation, regulations and treaties/accords whether actual or proposed;
5. indirect consequences of trends in regulation or business; and
6. climate change's physical impacts.

In a September 22, 2021, "illustrative" letter to issuers, the SEC provided a range of comments constituting a non-exhaustive list of factors companies should consider for General, Risk Factors, and Management's Discussion and Analysis of Financial Condition, and Results of Operations reporting categories.

### **Disgorgement May Be Alive and Well as an SEC Remedy**

Despite the limitations on disgorgement in *Liu v. SEC*, 140 S.Ct. 136 (2020), the Fifth Circuit Court of Appeals, on October 17, 2021, upheld awarding \$3 million to investors in Treaty Energy Corp.'s penny stock scam, finding that the SEC had meticulously identified specific individuals as victims defrauded. *Liu* had limited disgorgement to the net profits gained by the perpetrator and only in instances where victims would benefit. *SEC v. Blackburn*, No. 20-30464 (5<sup>th</sup> Cir., October 12, 2021). Further use of this remedy by an emboldened SEC can be anticipated.

### **Clawbacks of Compensation Pose a Renewed Threat to Executives**

The SEC is taking a renewed aim at executive pay, penalizing C-suite occupants for company accounting violations. The SEC on October 14, 2021, said it "would revive a rule left unfinished from the 2007-09 financial crisis that would require U.S.-listed companies to implement a plan to recoup executive compensation in the event they have to correct financial statements due to compliance failures," according to Reuters. Dodd-Frank legislation in 2010 authorized such agency action, but clawbacks have been rarely implemented and have proven hard to collect, as bonuses and other compensation are spent by officers, especially former ones.

In short, on these fronts, as well as others that Chairman Gensler has pressed, the SEC is on the march. If you have questions about these enforcement developments or how they may affect your business, please reach out to one of the authors or any member of Baker Donelson's [Government Enforcement and Investigations Team](#).