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2021 Mid-Year Securities Enforcement Update

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I. Introduction: Themes and Notable Developments

This mid-year update marks the first six months of the Commission under the Biden administration. Change came swiftly, yet is only just beginning. In this update, we look at the significant developments from the first six months of 2021, and consider what to expect from new leadership at the Commission and the Enforcement Division. In sum, it is safe to say that the next four years will see a return to increasing regulatory oversight and escalated enforcement of market participants.

As predicted in our 2020 Year-End Securities Enforcement Update, promptly after President Biden was inaugurated, the White House substituted then Acting Chairman Elad Roisman with the senior Democratic Commissioner, Allison Herren Lee.[1] Under Acting Chair Lee's leadership, the Commission began a number of initiatives that immediately signaled more aggressive and proactive regulatory oversight, including in areas of climate and environmental, social and governance (ESG) disclosure and investment management, and special purpose acquisition companies (SPACs), both of which are discussed further below. At the same time, Republican Commissioners often issued statements raising concerns about the approach being taken by the Commission in areas such as ESG disclosure and cryptocurrency.[2]

Shortly after her appointment to the Acting Chair position, Acting Chair Lee announced changes to the enforcement process that facilitated the opening of formal investigations and also added uncertainty to the settlement process for companies and SEC registered firms. In February, Acting Chair Lee restored the delegated authority of senior Enforcement Division staff to issue formal orders of investigation, which authorize the staff to issue subpoenas for documents and testimony.[3] The re-delegation of authority reversed the 2017 decision under the Trump administration which restricted authority to issue formal orders to the Director of the Enforcement or the Commissioners. Acting Chair Lee cited the need to allow investigative staff "to act more swiftly to detect and stop ongoing frauds, preserve assets, and protect vulnerable investors."[4] Immediately following that pronouncement, the Commission announced an end to the practice of permitting settling parties to make contingent settlement offers—offers to resolve an investigation contingent on receiving from the Commission a waiver of collateral consequences, such as disqualifications from regulatory safe harbors, which would otherwise arise from the violations. In her statement, Acting Chair Lee noted that "waivers should not be used as 'a bargaining chip' in settlement negotiations, nor should they be considered a 'default position' under the SEC."[5] Following the announcement, Commissioners Hester Peirce and Elad Roisman, both Republicans, issued a joint statement criticizing the impact of the policy reversal on parties seeking to resolve an investigation through a settlement "because it undercuts the certainty and finality that settlement might otherwise provide."[6]

In April, Gary Gensler was sworn in as Chairman of the SEC.[7] Before joining the SEC, Chairman Gensler was Chairman of the Commodity Futures Trading Commission in the Obama administration and presided over a period of heightened financial regulation and aggressive enforcement against major financial institutions.

In June, Chairman Gensler appointed Gurbir Grewal, the Attorney General for the State of New Jersey, as the new Director of the Division of Enforcement.[8] Mr. Grewal will begin his role as Division Director on July 26. With the appointment of Mr. Grewal, Chairman Gensler continues a trend, begun in the wake of the 2008 financial crisis, of appointing former prosecutors to the that position. Before becoming New Jersey Attorney General, Mr. Grewal had been the Bergen County Prosecutor, and Assistant U.S. Attorney in the District of New Jersey (where he was Chief of the Economic Crimes Unit) and in the Eastern District of New York (where he was assigned to the Business and Securities Fraud Unit). Mr. Grewal also worked in private practice from 1999 to 2004 and 2008 to 2010.

Now that the new Commission leadership is taking shape, we expect the coming months to reflect increasingly the influence of the new administration. Undoubtedly, this will translate into heightened scrutiny on legal and compliance departments and financial reporting functions of financial institutions, investment advisers, broker-dealers, and public companies.

A. Climate and ESG Task Force

In March, Acting Chair Lee announced the creation of a Climate and ESG Task Force.[9] The task force is composed of 22 members drawn from various Commission offices and specialized units. The Climate and ESG task force is charged with developing initiatives to identify ESG-related misconduct and analyzing data to identify potential violations. Additionally, the task force aims to identify misstatements in issuers' disclosure of climate risks and to analyze disclosure and compliance issues related to ESG stakeholders and investors. The SEC has also established a website and intake submission form for tips, referrals, and whistleblower complaints for ESG-related issues. The task force will work closely with other SEC Divisions and Offices, including the Division of Corporation Finance, Investment Management, and Examinations.

In April, the Division of Examinations issued a Risk Alert detailing its observations of deficiencies and internal control weaknesses from examinations of investment advisers and funds regarding investing that incorporates ESG factors.[10] The Division's Risk Alert provides a useful roadmap to assist investment advisers in developing, testing and enhancing their compliance policies, procedures and practices. Please see our prior client alert on this subject for an analysis of the lessons learned from the Division's Risk Alert.

B. Focus on SPACs

Over the course of the first half of this year, the SEC has been intensifying its focus on SPACs. Also referred to as blank check companies, SPACs are shell companies which offer private companies an alternative path to the public securities markets instead of an IPO. A SPAC transaction proceeds in two phases: (i) an initial phase in which the shell company raises investor funds to finance all or a portion of a future acquisition of a private company and (ii) a de-SPAC phase in which the SPAC merges with a private target company. During the de-SPAC phase, investors in the initial SPAC either sell their shares on the secondary market or have their shares redeemed. After the de-SPAC, the entity continues to operate as a public company. Typically, SPACs have two years to complete a merger with a private company.

Earlier this year, senior SEC officials in the Division of Corporation Finance and Office of the Chief Accountant issued a string of pronouncements concerning the risks posed by the explosion of SPAC initial public offerings in 2020 and early 2021, including a potential misalignment of interests and incentives between SPAC sponsors and shareholders.[11] Last week the Commission announced an enforcement action against a SPAC, the SPAC sponsor, and the CEO of the SPAC, as well as the proposed merger target and the former CEO of the target for misstatements in a registration statement and amendments concerning the target's technology and business risks.[12]

In a separate alert, we analyzed the important implications this enforcement action has for SPACs, their sponsors and executives for their diligence on proposed acquisition targets. To emphasize the point, SEC Chairman Gary Gensler took the unusual step of providing comments that echoed the concerns of senior officials and sent a clear message that even when the SPAC is "lied to" by the target, the SPAC and its executives are at risk for liability under the securities laws if their diligence fails to uncover misrepresentations or omissions by the target. Chairman Gensler stated, "This case illustrates risks inherent to SPAC transactions, as those who stand to earn significant profits from a SPAC merger may conduct inadequate due diligence and mislead investors. . . . The fact that [the target] lied to [the SPAC] does not absolve [the SPAC] of its failure to undertake adequate due diligence to protect shareholders."

C. Focus on Cybersecurity Risks

For a number of years, the Commission has been increasing its focus on controls and disclosures related to the risks of cyberattacks. In June, the Division of Enforcement publicly disclosed that it was conducting an investigation regarding a cyberattack involving the compromise of software made by the SolarWinds Corp.[13] As part of that investigation, the Division staff issued letters to a number of entities requesting information concerning the SolarWinds compromise. The inquiry is notable both for its public nature as well as the scope of the requests and signals a heightened scrutiny of how companies manage cyber-related risks.

D. Shifting Approach to Penalties against Public Companies

In addition to the overarching expectations for increasingly aggressive enforcement under this administration, the first half of this year also revealed indications that the Commission's approach to corporate penalties may be undergoing a transition.

For many years the Commission has debated whether, and to what extent, public companies should be subject to monetary penalties in settlement of enforcement actions based on allegations of improper accounting or financial reporting or misleading disclosures. On one hand, advocates for the imposition of substantial penalties argue that they are a statutorily authorized remedy that serves regulatory goals of specific and general deterrence and, since the creation of fair funds, the potential goal of financial remediation. On the other hand, imposing penalties on a public company is simply taking value away from current shareholders of the company, some of whom may also have been the victims of the alleged financial reporting misconduct, and, in the absence of a fair fund, simply transferring that value to the U.S. Treasury. In the wake of the corporate accounting scandals of the 2000s, the SEC's penalties against public companies rose to the hundreds of millions of dollars, leading to calls for a framework for the determination of appropriate penalties.

In an effort to bring some consistency to the Commission's and the Enforcement Division's approach to negotiating corporate penalties, in 2006 the Commission unanimously issued guidance on whether, and to what extent, the Commission should seek to impose penalties against public companies.[14] Rooting the guidance in the legislative history of the 1990 Congressional authorization of SEC penalty authority, the Commission's 2006 guidance identified two principal factors to determine whether a penalty against a public company would be appropriate: (1) whether the company received a direct financial benefit as a result of the alleged violation, and (2) the extent to which a penalty would recompense or harm injured shareholders. Although the 2006 guidance identified other relevant factors—such as the need for deterrence, egregiousness of the harm from the violation, level of intent, corporate cooperation—the first two factors were of paramount importance. As a general matter, in the years following the 2006 Guidance, the size of corporate penalties in financial reporting cases moderated.

In March of this year, Commissioner Caroline Crenshaw, a Democrat, delivered a speech[15] in which she criticized the 2006 guidance. Calling the guidance "myopic" and “fundamentally flawed,” Commissioner Crenshaw argued that the Commission should not treat the presence or absence of a corporate benefit as a threshold issue to imposing a penalty. Instead, the Commission should focus on factors such as: (1) the egregiousness of the misconduct, (2) the extent of the company’s self-reporting, cooperation and remediation, (3) the extent of harm to victims, (4) the level of complicity of senior management within the company in the alleged misconduct, and (5) the difficulty of detecting the alleged misconduct. Anecdotal experience suggests that a majority of the Commissioners, and consequently, the staff of the Enforcement Division, are following the principles outlined in Commissioner Crenshaw’s speech.

The significance of this for public companies is that the Commission’s approach to corporate penalties diverges from its statutory underpinnings. The securities laws provide for prescribed penalty amounts per violation.[16] In general, in litigated cases, district courts and administrative law judges have generally imposed reasonable limits on the penalties sought by the Commission.[17] If the Commission is no longer following the 2006 guidance, then untethered from a consideration of corporate benefit or shareholder cost-benefit, the Commission’s posture on corporate penalties is vulnerable to subjective assessments of egregiousness and corporate cooperation. Moreover, unlike calculations under the US Sentencing Guidelines, there is no public disclosure of exactly how the SEC reaches a particular penalty, leaving companies and counsel unable to understand the basis for any negotiated penalty amount.

E. Litigation Developments

In the SEC’s ongoing litigation against Ripple Labs, there were notable developments in the defendants’ ability to obtain discovery of the SEC Staff’s prior policy positions concerning whether digital currencies constitute securities. In the pending litigation against Ripple, filed at the end of 2020, the SEC alleges that Ripple’s sales of digital token XRP constituted unregistered securities offerings. In April, a Magistrate Judge hearing discovery disputes granted the defendants’ motion seeking discovery of internal SEC Staff documents bearing on whether XRP tokens are similar to other cryptocurrencies that the SEC Staff has deemed not to be securities. More recently, in July, the Magistrate Judge ordered that the defendants could take the deposition of William Hinman, the former Director of the SEC’s Division of Corporation Finance, regarding a speech he delivered as Division Director concerning whether, in the Staff’s view, certain digital tokens constitute securities. These discovery decisions provide notable precedent for obtaining discovery of evidence relevant to the positions of Commission Staff on policy issues that may be relevant to the issues pending in particular enforcement litigation.

F. Other Senior Staffing Updates

In addition to the confirmation of Chairman Gensler and appointment of Enforcement Director Grewal, there were a number of other changes in the senior staffing of the Commission:

- In April, Jane Norberg, Chief of the SEC’s Office of the Whistleblower, left the agency. Ms. Norberg had been with the Office of the Whistleblower since near its inception in 2012. The Office’s Deputy Chief, Emily Pasquinelli, has been serving as Acting Chief pending appointment of a new Chief.
- In May, Joel R. Levin, the Director of the Chicago Regional Office, left the SEC.[18] He had served as Director of the Chicago office since 2018. Associate Directors Kathryn A. Pyszka and Daniel Gregus have been serving as Regional Co-Directors pending appointment of a new Regional Director.
- In June, Chairman Gensler announced additions to his executive staff, including Amanda Fischer as Senior Counselor; Lisa Helvin as Legal Counsel; Tejal D. Shah as Enforcement Counsel; Angelica Annino as Director of Scheduling and Administration; Liz Bloom as Speechwriter to the Chair; Basmah Nada as Digital Director; and Jahvonta Mason as Special Assistant to the Chief of Staff.

- Also in June, Renee Jones joined the SEC as Director of the Division of Corporation Finance, while the Acting Director of the Division, John Coates, was named SEC General Counsel.[19] Jones previously served as Professor of Law and Associate Dean for Academic Affairs at Boston College Law School, is a member of the American Law Institute and has served as the Co-Chair of the Securities Law Committee of the Boston Bar Association. Mr. Coates had previously served as the SEC's Acting Director of the Division of Corporate Finance since February 2021. Before joining the SEC, he was Professor of Law and Economics at Harvard University.

G. Whistleblower Awards

Coming off another record year of whistleblower awards in 2020, the Commission has continued to issue awards at a record pace in the first half of 2021. There is no reason to believe that these awards will slow down given the importance of the program to the Commission. Through June of this year, the SEC's whistleblower program has awarded nearly $200 million to 45 separate whistleblowers. That is almost $100 million more than the first half of 2020, which was $115 million to 15 individuals. Overall, the SEC's whistleblower program has paid out approximately $937 million to 178 individuals since the start of the program.

In April, the SEC announced an award of over $50 million to joint whistleblowers for information that alerted the SEC to violations involving highly complex transactions that would have "been difficult to detect without their information."[20] This award is the second largest in the history of the program and reflects the Commission's dedication to recovering funds for harmed investors.

Other significant whistleblower awards granted during the first half of this year include:

- Four awards in January, including an award of almost $500,000 to three whistleblowers in connection with two related enforcement actions; nearly $600,000 to a whistleblower whose information caused the opening of an investigation, and for the whistleblower's ongoing assistance in the SEC's investigation; an award of more than $100,000 to a whistleblower whose independent analysis led to a successful enforcement action;[21] and an award of $600,000 to a whistleblower whose tip led to the success of an enforcement action.[22]
- Five awards in February, including a $9.2 million award to a whistleblower who provided information that led to successful related actions by the Department of Justice.[23] Additional awards in February included two awards totaling almost $3 million to two separate whistleblowers whose high quality information led to an enforcement action that resulted in millions of dollars to harmed clients;[24] and two awards totaling more than $1.7 million to two whistleblowers in separate proceedings relating to the new Form TCR filing requirement set forth in Securities Exchange Act Rule 21F-9(e).[25]
- Four awards in March, including over $500,000 to two whistleblowers for tips that revealed ongoing fraud;[26] an award of over $5 million to joint whistleblowers whose tip resulted in the opening of an investigation;[27] approximately $1.5 million to a whistleblower whose information and assistance led to a successful SEC enforcement action;[28] and an award of more than $500,000 to a whistleblower for information and assistance that led to the shutting down of an ongoing fraudulent scheme.[29]
- Three awards in April, including an award of approximately $2.5 million to a whistleblower whose information and assistance to the SEC contributed to the success of an SEC enforcement action;[30] a $3.2 million award to a whistleblower who alerted the SEC to violations and provided subject matter expertise to the staff that conserved SEC resources; and a $100,000 award to a whistleblower for

significant information and ongoing assistance.[31]

- Six awards in May, including two awards totaling $31 million to four whistleblowers, two of which received $27 million for providing the SEC with new information and assistance during an existing investigation; and two others who received $3.76 million and $750,000 respectively for independently providing the SEC with information that assisted an ongoing investigation.[32] Additional awards in May include an award of approximately $22 million to two whistleblowers for information and assistance that was “crucial” to a successful enforcement action brought against a financial services firm;[33] a $3.6 million award to a whistleblower whose information and assistance led to a successful enforcement action;[34] an award of more than $28 million to a whistleblower for information that caused both the SEC and another agency to open investigations that resulted in significant enforcement actions;[35] and an award of more than $4 million to a whistleblower who alerted the SEC to certain violations that led to the opening of an investigation.[36]
- Five awards in June, including an award of more than $23 million to two whistleblowers whose information and assistance led to successful SEC and related actions;[37] an award of $3 million to two whistleblowers who separately and independently provided the SEC with valuable information and ongoing assistance;[38] two awards totaling nearly $5.3 million to four whistleblowers who provided information that prompted the opening of two separate investigations;[39] and an award of more than $1 million to a whistleblower whose information and assistance led to multiple successful SEC enforcement actions.[40]

II. Public Company Accounting, Financial Reporting and Disclosure Cases

A. Financial Reporting Cases

Cases Against Public Companies and Executives

In February, the SEC announced settled charges against the former CEO and CFO of a company that provides Flexible Spending Account services for allegedly making false and misleading statements and omissions that resulted in the company’s improper recognition of revenue related to a contract with a large public-sector client.[41] The SEC’s order alleged that one of the company’s large public sector clients stated on multiple occasions that it did not intend to pay for certain development and transition work associated with an existing contract. The CEO and CFO allegedly directed the company to recognize $3.6 million in revenue related to this work without disclosing to internal accounting staff or to the company’s external auditor that the client’s employees denied that it owed these amounts to the company. Without admitting or denying the SEC’s findings, the CEO and CFO agreed respectively to cease and desist from further violations of the charged provisions, pay penalties of $75,000 and $100,000, and reimburse the company for incentive-based compensation received on the basis of the alleged violations.

In May, the SEC instituted a settled action against a sports apparel manufacturer for allegedly misleading investors as to the bases of its revenue growth and failing to disclose known uncertainties concerning its future revenue prospects.[42] The SEC’s order alleged that the company accelerated, or “pulled forward,” a total of $408 million in existing orders that customers had requested be shipped in future quarters and that the company attributed its revenue growth during the relevant period to a variety of other factors without disclosing to investors material information about the impact of its pull forward practices. The company agreed to cease and desist from further violations and to pay a $9 million penalty without admitting or denying the findings in the SEC order.

Cases Against Auditors and Accountants

In February, the SEC suspended two former auditors from practicing before the SEC in connection with settled charges alleging improper professional conduct during an audit of a now defunct, not-for-profit educational institution.[43] The auditors allegedly issued an audit report without following Generally Accepted Auditing Standards by, among other things, failing to obtain sufficient appropriate audit evidence or to properly prepare audit documentation. The resultant financial statements allegedly fraudulently overstated the college's net assets by $33.8 million. Without admitting or denying the findings, the auditors agreed to the suspension with the right to apply for reinstatement after three years and one year, respectively.

In April, the SEC instituted administrative proceedings against a Texas-based CPA for allegedly failing to register his firm with the Public Company Accounting Oversight Board (PCAOB) and alleged failures in auditing and reviewing the financial statements of a public company client.[44] The CPA allegedly failed to complete his application to register with the PCAOB and performed an audit while the application was incomplete. The audit allegedly failed to comply with multiple PCAOB Auditing Standards as well. The proceedings will be scheduled for a public hearing before the Commission.

B. Disclosure Cases

In February, the SEC announced settled charges against a gas exploration and production company and its former CEO for failing to properly disclose as compensation certain perks provided to the CEO and certain related personal transactions.[45] The alleged failures to disclose included approximately $650,000 in the form of perquisites, including costs associated with the CEO's use of the company's chartered aircraft and corporate credit card. The SEC took into account the company's significant cooperation efforts when accepting the settlement offer. The Company and CEO agreed, without admitting or denying to the SEC's findings, to cease-and-desist from further violations. Additionally, the CEO agreed to pay a civil penalty in the amount of $88,248.

In April, the SEC instituted a settled action against eight companies for allegedly failing to disclose in SEC Form 12b-25 "Notification of Late Filing" forms (known as Form NT) that their requests for seeking a delayed quarterly or annual reporting filing was caused by an anticipated restatement or correction of prior financial reporting.[46] The orders found that each company announced restatements or corrections to financial reporting within four to fourteen days of their Form NT filings despite failing to disclose that anticipated restatements or corrections were among the principal reasons for their late filings. The companies, without admitting or denying the findings, agreed to cease-and-desist-orders and paid penalties of either $25,000 or $50,000.

In May, the SEC announced settled charges against a firm that produces, maintains, licenses, and markets stock market indices.[47] The SEC's order alleged failures relating to a previously undisclosed quality control feature of one of the firm's volatility-related indices, which allegedly led it to publish and disseminate stale index values during a period of unprecedented volatility. The allegedly undisclosed feature was an "Auto Hold", which is triggered if an index value breaches certain thresholds, at which point the immediately prior index value continues to be reported. Without admitting or denying the SEC's findings, the firm agreed to a cease-and-desist order and to pay a $9 million penalty.

C. Disclosure and Internal Controls Case against Ratings Agency

In February, the SEC filed a civil action against a former credit ratings agency. The SEC's complaint alleged that the agency violated disclosure and internal control provisions in rating commercial mortgage-backed securities (CMBS).[48] According to the complaint, the credit ratings agency allowed analysts to make undisclosed adjustments to ratings models and did not establish and enforce effective internal controls over these adjustments for 31 transactions.

III. Investment Advisers and Broker-Dealers

A. Investment Advisers

In late May, the SEC filed a civil action against two investment advisers and their portfolio managers for allegedly misleading investors about risk management practices related to their short volatility trading strategy.[49] According to the SEC's complaint, the investment advisers made misleading statements about their risk management practices. During a period of historically low volatility in late 2017, the investment adviser firms increased the level of risk in the portfolios while assuring investors that the portfolios' risk profiles remained stable. The SEC's complaint alleged that a sudden spike in volatility in early 2018 led to trading losses exceeding $1 billion over two trading days. The SEC separately settled related charges with the Firm's Chief Risk Oficer.

In mid-June, the SEC announced that it had obtained an asset freeze and filed charges against a Miami-based investment professional and two investment firms for engaging in a "cherry-picking" scheme in which they allegedly channeled trading profits to preferred accounts.[50] The SEC alleged that beginning in September 2015, the firms diverted profitable trades to accounts held by relatives and allocated losing trades to other clients by using a single account to place trades without specifying the intended recipients of the securities at the time of the trade. According to the SEC's complaint, the preferred clients received approximately $4.6 million in profitable trades while the other clients experienced over $5 million in first-day losses.

B. Broker-Dealer Reporting and Recordkeeping

In May, the SEC announced settled charges against a Colorado-based broker-dealer for failing to file Suspicious Activity Reports (SARs).[51] The purpose of SARs is to identify and investigate potentially suspicious activity. The SEC's order alleged that for a three-year period, the broker-dealer failed to file SARs—or filed incomplete SARs—while it was aware that there were attempts to use improperly obtained personal identifying information to gain access to the retirement accounts of individual plan participants at the broker-dealer. The SEC's order noted significant cooperation by the broker-dealer and remedial efforts including anti-money laundering systems, replacing key personnel, clarifying delegation of responsibility, and implement new SAR-related policies and training.

IV. Cryptocurrency and Digital Assets

A. Registration Case

In May, the SEC filed a civil action against five individuals for allegedly promoting unregistered digital asset securities.[52] The defendants worked as promoters for an open-source cryptocurrency, raising over $2 billion dollars from retail investors. The SEC's complaint alleged that from January 2017 to January 2018, the promoters advertised the cryptocurrency's "lending program" by creating "testimonial" style videos that appeared on YouTube. According to the complaint, the defendants did not register as broker-dealers and also did not register the securities offering. The complaint seeks injunctive relief, disgorgement, and civil penalties from all five defendants.

B. Fraud Case

In February, the SEC filed a civil action against three defendants, a founder of two digital currency companies and promoters for the companies, for allegedly defrauding hundreds of retail investors out of over $11 million through digital asset securities offerings.[53] The SEC's complaint alleged that from December 2017 to January 2018, the individuals induced investors to purchase securities in the companies by claiming their trading platform was the "largest" and "most secure" Bitcoin exchange. The defendants then promoted the unregistered initial coin offering of their cryptocurrency, referred to as B2G tokens by telling investors that their cryptocurrency would be built on the Ethereum blockchain and would launch in April 2018. Instead, the SEC claims, the defendants misappropriated the investor funds for their personal benefit. The complaint seeks injunctive relief, disgorgement, and penalties, along with an officer and director bar for the founder and one promoter. The U.S. Attorney's Office for the Eastern District of New York and the Department of Justice Fraud Section announced parallel criminal charges against the promoter.

V. Meme Stocks

In the first half of this year, the SEC responded to the growing presence of 'meme stocks,' which undergo spikes of rapid growth in short periods of time largely in response to social media activity. In January, following a period of increased market activity in GameStop stock fueled by posts on the social media aggregator site Reddit, the SEC released an alert that warned investors against "jump[ing] on the bandwagon" and emphasized avoiding making investment decisions based on social media posts.[54]

A. Trading Suspensions

In February, the SEC suspended trading in an inactive company due to potentially manipulative social media activity attempting to artificially inflate the company's stock price.[55] The SEC's trading suspension order stated that in January 2021, several social media accounts coordinated to increase the share price of stocks for a Minnesota-based medical device company, although the company had not filed reports with the SEC since 2017 and its website and contact information were non-functional. During this time, the share price and trading volume of the company's securities increased. A few weeks later, the SEC suspended trading in the securities for 15 companies again in response to social media activity relating to the issuers, none of which had filed information with the SEC for over a year.[56] In total, the SEC suspended trading for 24 companies in February because of suspicious social media posts.

B. Fraud Case

In March, the SEC announced a filed civil action and an asset freeze against a California-based trader for allegedly using social media to post false information about a company, while selling his own holdings in the company's stock.[57] The SEC's complaint alleged that the defendant purchased 41 million shares of stock from a defunct company with publicly traded securities. In the same day, the trader allegedly made over 120 tweets containing false information about the company, including that the company recently revived its operations and expanded its business. As an example, one of the posts alleged that the company had "huge" investors and the CEO had "big plans" for the company's future. In the following days, the company's share price increased by over 4,000 percent, at which point the defendant sold his shares for a profit of over $929,000 dollars and continued to post on Twitter about the company's success. The complaint seeks a permanent injunction, disgorgement, and a civil penalty. The SEC also temporarily suspended trading in the company's securities.[58]

VI. Insider Trading

In March, the SEC filed settled charges against a California individual for perpetuating a scheme to sell "insider tips" on the dark web.[59] This is the SEC's first enforcement action involving alleged securities violations on the dark web, a platform allowing users to access the internet anonymously. The complaint alleged that the individual falsely claimed to possess material, nonpublic information, which he sold on the dark web. Several investors purchased the individual's purported tips and traded on the information he provided. The individual agreed to a bifurcated settlement (which reserves the determination of disgorgement and penalties for a later date); the U.S. Attorney's Office for the Middle District of Florida announced parallel criminal charges.

In June 2021, the SEC announced settled charges against a New York-based couple for insider trading relating to the stock of a pharmaceutical company where one of them worked as a clinical trial project manager.[60] According to the SEC's complaint, the project manager learned of negative results from the drug trial she oversaw, and tipped another individual who sold all of his stock in the pharmaceutical company ahead of the public news announcement. The individual also tipped his uncle, who also sold all of his stock. After the negative news was announced, the company stock fell approximately 50%, which would have led to losses of over $100,000 for the individuals had the individuals not sold their stock. The individuals have agreed to pay around $325,000 to settle the charges.

VII. Regulation FD

In the twenty years since the adoption of Regulation FD, which prohibits selective disclosure by public companies of material, non-public material information, the Commission has filed only two litigated enforcement actions alleging violation of the Rule. The first case, filed against Seibel Systems in 2005, ended swiftly when the district court granted the defendants' motion to dismiss the Commission's complaint for failure to state a claim.[61] More than fifteen years later, in March of this year, the SEC filed a litigated action against AT&T and three investor relations employees.[62] The complaint alleges that the three IR employees selectively released material financial data in March and April of 2016. Specifically, the SEC alleges that the IR employees disclosed material nonpublic information to a group of analysts at twenty research firms in an effort to avoid the Company's quarterly revenue falling short of the analyst community's estimates. AT&T issued a statement in response explaining that any information discussed in communications with analysts was public and immaterial.[63] Among other things, AT&T noted that the information discussed with analysts "concerned the widely reported, industry-wide phase-out of subsidy programs for new smartphone purchases and the impact of this trend on smartphone upgrade rates and equipment revenue…. Not only did AT&T publicly disclose this trend on multiple occasions before the analyst calls in question, but AT&T also made clear that the declining phone sales had no material impact on its earnings." Notably, AT&T highlighted the fact that the Commission's complaint "does not cite a single witness involved in any of these analyst calls who believes that material nonpublic information was conveyed to them."

VIII. Offering Frauds

The SEC continued to bring a large number of offering fraud cases in the first half of 2021.

A. Investment Frauds

In January, the SEC filed two civil actions; the first was against a real estate broker and his company for raising $58 million from investors in two real estate funds by using a fabricated investment record.[64] The SEC's complaint also alleged that the broker, who had no investment management experience, misappropriated over $7 million in investor assets to conceal losses that ultimately forced the funds to wind down. In the second action, the SEC filed a complaint against an entertainment company and its founder for using a "boiler room" sales scheme to raise money from investors.[65] According to the complaint, the company employed salespeople who utilized high-pressure tactics and made misrepresentations about the company's growth in order to raise $14 million from individual investors. Both complaints seek disgorgement, injunctive relief, and civil penalties.

In early March, the SEC filed charges against seven individuals and a technology company for an alleged scheme to raise the price of the company's stock, after which they sold their shares for proceeds of over $22 million.[66] The complaint also alleged that during this campaign, approximately $22.8 million was raised from investors who were allegedly misled about the true nature of the company and that a large portion of the money raised from investors was used for personal expenses. The complaint seeks disgorgement, civil penalties, and injunctive relief.

In mid-March, the SEC announced three cases relating to investor frauds. The SEC filed a civil complaint against a New Jersey resident for defrauding potential investors, most of whom were members of the Orthodox Jewish community, including friends and family of the defendant.[67] According to the complaint, the defendant raised millions of dollars using misleading and false representations regarding his real estate investment company, which purchased and owned apartment complexes. The individual defendant agreed to settle the charges against him subject to court approval; the U.S. Attorney's Office for the District of New Jersey filed parallel criminal charges. The SEC also filed a civil complaint against an individual who raised money from investors in his company by making representations that was an environmentally friendly drink bottling and manufacturing company.[68] The complaint alleged that in reality, the company had no operations, and the money was used by the defendant for personal expenses. The SEC obtained emergency relief in this matter and the seeks complaint injunctive relief and civil penalties. Finally, the SEC filed charges against the two co-founders of a San Francisco-based biotech company for raising funds from investors by misrepresenting their company as a fast-growing medical company that could improve people's lives via new inventions in the "microbiome industry."[69] The complaint alleged that the co-founders' claims regarding their clinical testing were based on false medical tests and other improper practices. The U.S. Attorney's Office for the Northern District of California filed parallel criminal charges against the co-founders.

In April, the SEC filed a pair of civil actions against firms and their executives for conduct which resulted in significant investor losses. In the first action, the SEC alleged that an Israeli-based company and two of its former executives created a binary option securities trading platform in which investor losses were probable, and failed to inform investors that their partners were counterparties on the options.[70] In the second action, the SEC alleged that an individual and investment adviser misled investors regarding the strategy for his fund, and induced them to invest in highly illiquid companies and real estate rather than liquid assets as promised.[71] The complaint further alleged that the individual misappropriated fund assets for personal uses and failed to disclose all conflicts of interest. The U.S. Attorney's Office for the Southern District of New York filed parallel criminal charges against the individual.

In May, the SEC filed charges against a New Jersey-based healthcare company and its founder for fraudulently raising money from investors by selling them membership interests in a company that purportedly offered employers a supplemental medical reimbursement plan.[72] The complaint alleged that the individual defendant raised money from investors through various misrepresentations, including failing to disclose his prior felony convictions and history of regulatory violations. The complaint seeks disgorgement, injunctive relief, and civil penalties.

B. Ponzi-Like Schemes

In February, the SEC filed a civil action against three individuals and their affiliated entities alleging that they conducted a Ponzi-like scheme that raised more than $1.7 billion.[73] The complaint alleged that the defendants promised investors an 8% annualized distribution payment, and represented that it was generated by portfolio companies when it was in fact sourced from other investor money. The complaint seeks disgorgement and civil penalties.

In March, the SEC filed a settled complaint against an individual for operating a decade-long fraud in which he transferred poorly performing assets from a fund controlled by him to two private hedge funds.[74] The defendant told investors that these funds were generating positive returns when a substantial number of the investments were actually used to make Ponzi-like payments to prior investors. The defendant agreed to settle to these charges, and also pled guilty to related criminal charges in the District of New Jersey.

In April, the SEC filed two civil actions alleging Ponzi-like schemes. In the first action, the SEC alleged that an actor raised $690 million by promising investors high returns by telling them that they were buying film rights which he would resell to HBO and Netflix.[75] The defendant allegedly paid investors the returns using new investments, and also misappropriated investor funds for his personal use. In the second action, the SEC's complaint alleged that the defendant raised more than $17.1 million from over 100 investors by promising investors annual returns between 10% and 60% on resale of "customer lead generation campaigns."[76] According to the complaint, the defendant instead use the investments to make payments to other investors and entities, as well as for personal expenses.

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Gibson Dunn is one of the nation's leading law firms in representing companies and individuals who face enforcement investigations by the Securities and Exchange Commission, the Department of Justice, the Commodities Futures Trading Commission, the New York and other state attorneys general and regulators, the Public Company Accounting Oversight Board (PCAOB), the Financial Industry Regulatory Authority (FINRA), the New York Stock Exchange, and federal and state banking regulators.

Our Securities Enforcement Group offers broad and deep experience. Our partners include the former Director of the SEC's New York Regional Office, the former head of FINRA's Department of Enforcement, the former United States Attorneys for the Central and Eastern Districts of California, and former Assistant United States Attorneys from federal prosecutors' offices in New York, Los Angeles, San Francisco and Washington, D.C., including the Securities and Commodities Fraud Task Force.

Securities enforcement investigations are often one aspect of a problem facing our clients. Our securities enforcement lawyers work closely with lawyers from our Securities Regulation and Corporate Governance Group to provide expertise regarding parallel corporate governance, securities regulation, and securities trading issues, our Securities Litigation Group, and our White Collar Defense Group.

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