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INSIDER TRADING & DISCLOSURE UPDATE

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Editors' Remarks

Welcome to the latest issue of the Insider Trading & Disclosure Update, Debevoise's periodic update focusing on recent legal, compliance and enforcement developments in the areas of insider trading, the management of material nonpublic information and disclosure-based matters.

In this Update, we highlight legislation recently passed by the House of Representatives that would for the first time establish a statutory framework for insider trading liability. Also figuring prominently in this Update are two case-related developments at the Supreme Court — a decision in *Lorenzo* and its bearing on "scheme" liability under the Securities Exchange Act of 1934, and the Court's dismissal of *Emulex*, leaving unresolved questions relating to tender offer liability under the Exchange Act — and an update on the *Blaszczak* appeal regarding the defendants' insider trading convictions under the Sarbanes-Oxley Act's criminal fraud and securities fraud provisions, as well as updates on various SEC enforcement and disclosure-related developments.

We hope that you find this Update useful and informative, and we look forward to bringing you further news and analyses in future issues.

Sincerely,

The Editorial Board

Case Law & Market Updates

Proposed Legislation to Establish a Uniform Insider Trading Standard Gains Momentum in Congress

On December 5, 2019, the House of Representatives passed a bill that would bring insider trading law firmly within the statutory framework of the Securities Exchange Act of 1934 (the "Exchange Act") and clarify the standard for insider trading liability. The *Insider Trading Prohibition Act*, H.R. 2534 (the "Insider Trading Act"), sponsored by Jim Himes (D-CT), seeks to create a consistent standard for defining insider trading by adding new Section 16A

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to the Securities Exchange Act of 1934 (the "Exchange Act"). While Rule 10b5-1 of the Exchange Act currently prohibits individuals from trading while in possession of material nonpublic information ("MNPI"),[1] the body of law governing insider trading has largely been developed by the courts. The Insider Trading Act establishes two grounds for insider trading liability: (i) trading while aware of MNPI and (ii) communicating MNPI.

Trading Liability

The bill prohibits a person who is aware of MNPI relating to a security or security-based swap or swap agreement, or any nonpublic information, from whatever source, that has, or would reasonably be expected to have, a material effect on the market price of any such security, from trading directly or indirectly in that security if the person knows, or recklessly disregards, that such information has been obtained "wrongfully," or that the trade would constitute a wrongful use of such information. "Wrongful" acts — a standard that broadens the current reach of insider trading law which hinges on deceptive actions — are specified forms of unauthorized conduct, including: (i) theft, bribery, misrepresentation or espionage (through electronic or other means); (ii) a violation of any Federal law protecting computer data or the intellectual property or privacy of computer users; (iii) conversion, misappropriation or other unauthorized and deceptive taking of such information; or (iv) a breach of any fiduciary duty, confidentiality agreement, contract, code of conduct, ethics policy or any other personal or other relationship of trust and confidence for a direct or indirect personal benefit.

"Tipping" Liability

The bill prohibits individuals whose trading itself would be prohibited under the law's trading prohibition from "wrongfully" communicating MNPI relating to the relevant security or any nonpublic information, from whatever source, that has, or would reasonably be expected to have, a material effect on the market price of any such security, to any other person if: (i) the other person trades or causes trading in the security to which the communication relates or communicates the information to another person who trades or causes trading in the security while aware of such information, and (ii) such trading while aware of such information is reasonably foreseeable. While the legislation does not explicitly address "tippee" liability, presumably a tippee's liability would be determined within the framework of the bill's prohibition on trading.

The bill also provides exemptions for employers who do not participate in or directly or indirectly induce an employee's unlawful trades or communications, those acting on behalf of a person whose activities are

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lawful, and other persons, securities, transactions, or classes of such, as designated by the SEC.

While the Insider Trading Act was unanimously approved by the House Financial Services Committee in September 2019, Republicans on the Committee raised several concerns with the legislation at that time.[2] In response to those concerns, the House adopted by voice vote an amendment proposed by Patrick McHenry (R-N.C.) during the December 5, 2019 vote on the bill. The House approved the measure, as amended, by a vote of 410-13. Rep. McHenry's amendment made several notable changes to the legislation. As originally introduced, H.R. 2534 sought to eliminate the confusion relating to various aspects of tipper/tippee liability following in the wake of *United States v. Newman*[3] and its progeny by establishing that "tipper" liability need not be predicated on there being a "personal benefit" to the tipper. However, despite the bill sponsor's original intent, the version of the legislation passed by the House now explicitly requires that a tipper have received a direct or indirect personal benefit. The McHenry amendment made clear that such a benefit need not be limited to pecuniary gain but may also be a reputational benefit or a gift of confidential information to a trading relative or friend.[4] Rep. McHenry stated on the House floor that Republicans also seek to include an exclusivity provision in the bill by way of a future amendment that would make the measure the "exclusive law of the land for insider trading."[5]

Though the measure does not currently have bipartisan sponsorship, with the addition of Rep. McHenry's amendments, the legislation is said to represent potentially "workable language that could be acceptable to all in this body."[6] Nevertheless, predictive analysis currently indicates that the proposal has only a slight chance of enactment, likely because of the lack of bipartisan sponsorship.[7] The legislation will now go to the Senate for consideration.[8]

U.S. Supreme Court Affirms 10b-5 "Scheme" Liability but Drops Tender Offer Liability from Docket

As we reported in the February 2019 issue of the Insider Trading & Disclosure Update, the U.S. Supreme Court was set to decide two very different securities-related issues that could have had wide-ranging impacts for litigants.

Lorenzo v. SEC

In *Lorenzo v. SEC*, the Supreme Court affirmed the D.C. Circuit Court's opinion and held that "the [d]issemination of false or misleading statements with intent to defraud can fall within the

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scope of Rules 10b–5(a) and (c), as well as the relevant statutory provisions, even if the disseminator did not 'make' the statements and consequently falls outside Rule 10b–5(b)."[1] The decision provides much-needed guidance as to what type of conduct suffices to establish scheme liability under Rules 10b-5(a) and (c) of the Securities Exchange Act of 1934 (the "Exchange Act") in the wake of the Court's seminal decision *Janus Capital Group, Inc. v. First Derivative Traders*,[2] which held that the "maker" of a statement for purposes of 10b-5(b) liability is the person with "ultimate authority" over its content. The SEC had charged Francis Lorenzo, an investment banker at a registered broker-dealer, with violating Rule 10b-5 in connection with e-mails that he sent to investors concerning a bond offering. The e-mails, which allegedly omitted information concerning massive write-downs on the issuer's assets, were drafted by Lorenzo's boss but sent from Lorenzo's e-mail account. Under *Janus*, Rule 10b-5(b)'s prohibition against "mak[ing] any untrue statement of material fact" only applies to the person, fund, or entity that was the "maker" of the statement — in other words, "the person or entity with ultimate authority over the statement, including its content and whether and how to communicate it," and not merely "[o]ne who prepares or publishes a statement on behalf of another."[3] Consistent with *Janus*, the D.C. Circuit concluded on appeal that Lorenzo had not "made" the misstatements but the divided panel nevertheless held that the SEC properly imposed liability on Lorenzo for employing a "device, scheme, or artifice to defraud . . . in connection with the purchase or sale of any security."[4] In doing so, the D.C. Circuit expressly rejected Lorenzo's argument that "Janus would effectively be rendered meaningless" by such a decision, and found instead that "Rules 10b-5(a) and (c), as well as Sections 10(b) and 17(a)(1), may encompass certain conduct involving the dissemination of false statements even if the same conduct lies beyond the reach of Rule 10b-5(b)."[5] In its opinion, the Court acknowledged that its holding would render the same conduct subject to primary liability (under Rules 10b-5(a) and (c)) and secondary liability (for substantially assisting another person's violation of Rule 10b-5(b)) but found that concern unpersuasive given that the criminal law likewise contains examples of the same conduct giving rise to both primary and secondary liability. As the dissent noted, the *Lorenzo* decision will likely make it easier for the SEC and private plaintiffs to more easily "re-label [a] person's involvement [in an alleged misstatement or omission] as an 'act,' 'device,' 'scheme,' or 'artifice' that violates Rule 10b-5(a) or (c)."

Emulex Corp. et al., v. Varjabedian

In *Emulex*, the Supreme Court was set to decide (and resolve a significant Circuit split as to) whether liability in privately-

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litigated actions under Section 14(e) of the Exchange Act may be based on a negligent misstatement or omission made in connection with a tender offer rather than the higher scienter pleading standard for fraud claims under Section 10(b) of the Exchange Act.[6] While the issue before the Court was a narrow one, the petitioners and the U.S. Chamber of Commerce, through an *amicus* brief, put the "more fundamental issue" of whether Section 14(e) supports an inferred private right of action at all squarely before the Court,[8] thereby adding potential further import to the Court's decision. Shortly following oral argument in the case, the Court dismissed the grant of *certiorari* in the case as having been "improvidently granted."[7] The Court's decision leaves in place the existing Circuit split, with "negligence" being the standard in the Ninth Circuit Court and "scienter" being the standard in the Second, Third, Fifth, Sixth and Eleventh Circuit Courts, and more fundamentally leaves in place the inferred private right of action under Section 14(e).

Second Circuit Hears Arguments on U.S.C. Title 18 Insider Trading Prosecutions

The U.S. Court of Appeal for the Second Circuit recently heard oral arguments on appeals brought by four defendants convicted of insider trading under 18 U.S.C. §§ 1343 and 1348 — the Sarbanes-Oxley Act's criminal wire fraud and securities fraud provisions. If the Court upholds the convictions under § 1343 and 1348 in *United States v. Blaszczak*,[1] it could represent an unprecedented expansion of insider trading liability by significantly reducing the burden of proof for prosecutors.

Prosecutors in *Blaszczak* alleged that between 2009 and 2014 a government employee provided material non-public information ("MNPI") about Medicare reimbursement rates to a political intelligence consultant.[2] The consultant was alleged to have tipped the MNPI to a partner and an analyst at Deerfield Management Company, L.P., a healthcare-focused hedge fund. At trial, the judge instructed the jury that a conviction under Section 10(b) of the Exchange Act required a breach of a duty for personal gain, but declined to give a similar instruction for the counts under Title 18. The jury subsequently acquitted the defendants of insider trading under Section 10(b), but convicted the defendants under 18 U.S.C. §§ 1343 and 1348.[3] On appeal, the defendants decried the government's "unprecedented use of those statutes to execute an end-run around established limitations on fraud . . . that are essential to protect investment professionals and promote

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market efficiency."[4] The defendants argued that any fraud-based insider trading theory requires the government to show the breach of a duty for a personal benefit, and that tippee liability requires the government to show that the tippee knew of the breach.

If the convictions stand, the government may no longer need to prove the "knowledge" or "personal benefit" elements to successfully prosecute insider trading violations, and future insider trading defendants could face criminal convictions even where no liability could attach under the anti-fraud provisions of Section 10(b).

Regulations S-K & S-X: The Year in Review

Over the course of 2019, the Securities and Exchange Commission's Disclosure Effectiveness Initiative[1] has continued to produce incremental changes to Regulations S-K and S-X, streamlining a number of disclosure requirements and introducing new technology-driven requirements.

Updates to Regulation S-K

On March 20, 2019, the SEC announced the adoption of final rules that simplify and modernize certain disclosure requirements under Regulation S-K. The most significant changes include: (i) the elimination of the requirement to submit confidential treatment requests for exhibits, (ii) the elimination of the MD&A requirement to include three full years of discussion and analysis if the earliest year was included in an earlier filing and (iii) a new technology-driven requirement to include inline XBRL tagging of all information on the cover page of Form 10-K, 10-Q, 8-K, 20-F and 40-F filings.[2] For more information about these rule amendments, please see our more detailed Client Update here.

Proposed Revisions to Regulation S-K

On August 8, 2019, the SEC announced proposed amendments to Items 101 (Description of Business), 103 (Legal Proceedings) and 105 (Risk Factors) of Regulation S-K. SEC Chairman Jay Clayton has publicly commented that "[t]he proposals reflect a thoughtful mix of prescriptive and principles-based requirements that should result in improved disclosures and the elimination of unnecessary costs and burdens." The further incorporation of principles-based disclosure requirements in Regulation S-K is a continuation of the SEC's efforts to increase the effectiveness of disclosure for investors while enhancing efficiency and reducing the overall burden of disclosure for registrants. A full description of the proposed amendments is available on the SEC's website (click here).

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The comment period for the proposed amendments to Regulation S-K closed on October 22, 2019, and the SEC received a reasonably large number of comments in response. The responses generally fell into two categories: in the first, companies applauded the Staff's efforts to modernize and simplify disclosure requirements; and in the second, individuals expressed concerns that the proposed rules would allow companies to reduce the transparency of their disclosure, and leave investors without adequate information. Within these broad categories, commenters also provided a range of suggestions (some quite specific) intended to reshape aspects of the rule proposals. For instance, with regard to the SEC's proposal to amend Item 101(c) of Regulation S-K to require additional disclosure regarding "human capital resources,"[3] one corporate commenter suggested that companies should be required to disclose their diversity and inclusion efforts while another corporate commenter was of the view that by providing non-exclusive examples of human capital metrics and objectives that may be material, the proposed rules could engender the disclosure of immaterial information that fails to account for the differences among business sectors. This commenter further suggested that the Commission publish interpretative guidance on the human capital disclosure requirements to provide clarity and promote consistency.

Proposed Revisions to Regulation S-X

On May 3, 2019, the SEC published proposed amendments to Regulation S-X intended to improve the information available to investors regarding acquisitions and dispositions and to reduce compliance costs for registrants. More specifically, the proposed rule changes include, among other amendments: (i) revisions to the test for calculating the significance of an acquisition (which bears on the requirements relating to the inclusion in Securities Act registration statements of separate financial statements for acquired businesses, as well as related pro forma financial statements) in order to eliminate anomalous results (such as the application of the "absolute value rule" under the current requirements), (ii) an expansion of the ability to provide abbreviated carve-out financial statements in connection with the acquisition of business components and (iii) new requirements related to the presentation of pro forma financial information.

The comment period closed July 29, 2019, but the SEC has yet to announce the adoption of the final rules. A number of law firms, including Debevoise (our comment letter can be found here), accounting firms and public companies submitted comments on the proposed rules. Among other things, our comment letter highlighted the

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fact that not extending the proposed amendments to Rule 3-05 of Regulation S-X (financial statements of businesses acquired or to be acquired) and Article 11 of Regulation S-X (Pro Forma Financial Information) to registration statements on Form S-4 and F-4 would lead to disparate reporting requirements and could cause uncertainty in the acquisition financing markets regarding financial statement requirements. All of the Big Four accounting firms also submitted comment letters on the proposed rules. Three of the four recommended that the SEC define the new term "recurring annual revenue" included under the proposed new Rule 3-05 income significance test to ensure consistent application. Half of the firms also recommended that the SEC continue to use pre-tax income, as opposed to after-tax income, for purposes of calculating the Rule 3-05 income significance test because the use of after-tax income could produce less consistent significance determinations among companies due to differences in capital structure, domicile and other circumstances that can materially impact tax expenses.

Looking Ahead

When the SEC adopted the final disclosure simplification rules in March, only two proposed rules were not adopted. In each case, commenters had largely responded negatively due to the potential to make disclosure filings more opaque to investors and more complex and time-consuming for registrants. Based on the comment letters sent in response to the proposed revisions to Regulations S-X and S-K, as well as the general momentum behind the SEC's efforts with regard to disclosure reform and effectiveness, it is reasonable to think that the SEC will adopt these proposed rules in form substantially similar to the rule proposals.

SEC Charges Pharmaceutical Company with Regulation FD Violation

Pharmaceutical company TherapeuticsMD, Inc. recently settled the first standalone Regulation Fair Disclosure ("Regulation FD") action brought by the SEC in over five years. The settled order alleged that TherapeuticsMD twice violated Regulation FD by selectively disclosing MNPI about TX-004HR, a hormonal drug for the treatment of dyspareunia.[1] The order may indicate renewed interest from the SEC in enforcing Regulation FD, which prohibits public companies from selectively disclosing MNPI to securities market professionals and other enumerated persons.

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The SEC alleged that TherapeuticsMD applied to the Food and Drug Administration ("FDA") for approval of TX-004HR in July 2016. The following May, however, the FDA expressed concerns about the application's lack of data on the drug's long-term safety. TherapeuticsMD arranged a meeting with the FDA in June 2017, and filed a Form 8-K disclosing that the meeting would likely have one of two results: either the FDA would permit TherapeuticsMD to restart the approval process, or TherapeuticsMD would resort to formal dispute resolution with the agency.

When the FDA meeting provided no clear path to approval, TherapeuticsMD allegedly committed its first Regulation FD violation. After the meeting, the company emailed several sell-side research analysts that the meeting had been "very positive and productive." TherapeuticsMD's stock price closed up 19.4% the following day. Although Regulation FD requires that an intentional selective disclosure be accompanied by a simultaneous public disclosure,[2] TherapeuticsMD waited until July 2017, when it received formal meeting minutes from the FDA, to release a Form 8-K about the meeting (the "July 8-K"). The Form 8-K stated that the company had "present[ed] new information" to the FDA but also disclosed that TX-004HR was not on a formal timeline for approval. In response, the company's stock price fell 16%.

On the morning that TherapeauticsMD released the July 8-K, the company allegedly made further selective disclosures. On a call with sell-side analysts, TherapeuticsMD executives described the "new information" submitted to the FDA. They followed up on the call by emailing to the analysts three studies that TherapeuticsMD had submitted to the FDA and a summary of the company's Chief Medical Officer's position on TX-004HR's safety. Each analyst promptly published research notes that detailed the more specific information about the FDA interactions, in several cases repeating the company's positive conclusions about the studies. The stock rebounded, finishing down only 6.6% by market close. TherapeuticsMD waited another two weeks to disclose the same data publicly.

The SEC charged the Company with violations of Section 13(a) of the Exchange Act and Regulation FD thereunder and imposed a monetary penalty of $200,000. According to the SEC, the penalty took into account subsequent remedial actions, including the company's implementation of improved policies and procedures to ensure compliance with Regulation FD. The order's singular focus on Regulation FD was unusual: although the SEC actively enforced the regulation in the immediate aftermath of the 2008 financial crisis,[3] the SEC has rarely pursued standalone Regulation FD actions in recent years.[4]

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It is likely that the intentional nature of TherapeuticsMD's selective disclosures, as well as the company's previous lack of relevant policies and procedures, influenced the SEC's decision to initiate the action. However, the settled order serves as a reminder that even simple descriptive language, such as characterizing a meeting as "positive" and "productive," can have material impacts in some circumstances.

Congressman Ensnared by Insider Trading Action

Former U.S. Congressman Chris Collins of New York resigned from the House of Representatives on September 30, 2019 before pleading guilty to insider trading charges the next day. On December 9, 2019, the SEC announced that it had entered into a settlement with Collins, which, among other things, permanently bars Collins from serving as an officer or director of any public company. The settlement is the latest development in the highly publicized saga that began in August of 2018, when Collins was arrested in connection with the charges. The former Congressman will be sentenced on January 17 and could face up to 10 years in prison for the two charges.[1] Under the plea agreement, prosecutors have recommended a sentence of 46 to 57 months, which Collins has agreed not to appeal.

The charges, conspiracy to commit securities fraud and lying to federal investigators, are tied to Collins' involvement with Australian biopharmaceutical company, Innate Immunotherapeutics. Collins was one of Innate's largest shareholders, holding approximately 17% of its shares, and was on the company's board of directors. Collins had also encouraged various people, from his children to his staff to fellow members of Congress, to invest in Innate, and many did.

Collins was attending an event at the White House in June of 2017 when he received an email from Innate's chief executive directed at Collins and other board members. The email revealed that MIS416, an experimental multiple sclerosis drug and, at the time, Innate's only potential product, had failed a critical drug trial. Collins did not trade on the information, as before the news was publicly announced, a hold was placed on Innate shares in the Australian stock exchange, where Collins held his shares. However, immediately after learning of the failed trial, Collins called his son Cameron Collins, who held Innate shares in the U.S. over-the-counter market, and instructed him to sell his shares. Cameron Collins

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sold his shares and also instructed his father-in-law, Stephen Zarsky, to sell his shares based on the trial results. The tip from Collins saved his son and Mr. Zarsky over $700,000 in losses as Innate's stock fell by more than 90% after the results of the trial were publicly announced. Cameron Collins and Mr. Zarsky also face insider trading charges in connection with the sale and also entered into a settlement with the SEC on December 9, 2019, pursuant to which they have agreed to disgorge their avoided losses.

Focus on Gatekeepers in Recent Insider Trading Enforcement

As was the case in the Collins prosecution, the SEC's civil enforcement has recently focused on tipping in a number of cases, particularly in cases involving "gatekeepers," such as attorneys and accountants as well as other professionals. At the Securities Docket 2018 Enforcement Forum in Washington, D.C., Enforcement Division Chief Counsel Joseph Brenner remarked that the SEC has recently seen an increase in the number of cases involving gatekeepers, which he found to be a "disturbing" development. Recent insider trading enforcement activity involving professionals or other gatekeepers include:

- Former Apple Inc. senior attorney and global head of corporate law Gene Levoff being indicted on federal fraud and insider trading charges in connection with his alleged trading of Apple securities based on non-public revenue and earnings data. Levoff is also the subject of an SEC civil lawsuit.[1]
- Former SeaWorld Entertainment Inc. associate general counsel Paul Powers pleading guilty to federal charges resulting from his purchasing shares shortly before, and selling shares shortly after, the company announced positive results in a quarterly earnings release.[2]
- Federal prosecutors charging investment bankers from Goldman Sachs, Moelis & Co and Centerview Partners in connection with an alleged multi-year scheme in connection with which the bankers provided insider client information to securities traders in exchange for cash and other gifts.[3]
- A New Jersey man, Tai-Cheng Yang, settling with the SEC after acquiring Whole Foods securities before the grocery chain's acquisition by Amazon was announced. Yang learned of the transaction after a relative, who was working on the deal, disclosed to Yang's wife that due to his work on the transaction he would have to miss a family commitment.[4]

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SEC's Division of Enforcement Annual Report for Fiscal Year 2019 Marks End to a Busy Year

On November 6, 2019, the U.S. Securities and Exchange Commission (the "SEC" or "Commission") released its 2019 Annual Report (the "Report"), which details the activities and results of the Division of Enforcement (the "Division") for the period October 1, 2018 to September 30, 2019. Enforcement trends held steady in fiscal 2019, tracking the lower-trending top-line numbers that the market has come to expect during the Trump Administration. The Commission returned $1.197 billion to harmed investors in FY 2019, a 50% increase from FY 2018 that principally stemmed from three Fair Funds and one disgorgement fund resulting from cases resolved some years ago that distributed $902 million to harmed investors.

Disclosure-related cases against investment firms as well as issuers were an important focus for the SEC during the period. Of the 526 standalone actions brought in fiscal 2019, the Division highlighted actions against 95 investment advisory firms in connection with the SEC's 2018 Share Class Disclosure Initiative; 92 actions related to issuer financial reporting and disclosures issues; and 30 actions against individuals who allegedly misappropriated or traded unlawfully on material, nonpublic information.

Share Class Disclosure Initiative

Featuring prominently in the SEC's disclosure docket was a series of settlements announced in connection with the agency's 2018 Share Class Disclosure Initiative. The Initiative targeted investment advisers that insufficiently disclosed their receipt of fees on certain share classes into which investors' assets were placed, in spite of a cheaper share class being available to the same investors.[1] The settlements contained identical terms across the respondent firms, and were announced in two waves: the first in March 2019, and the remainder in September 2019. In all, the SEC touted more than $135 million returned to investors through the self-disclosure and abbreviated settlement process. At the October 23, 2019 SEC Enforcement Forum, Enforcement Co-Director Steven Peikin indicated that the Commission was pleased with the success of the Initiative, which fit well with the agency's renewed focus on retail investors, but was "perplexed" by criticisms that the approach adopted by the Division of Enforcement amounts to regulation by enforcement. Asked if the market can expect similar initiatives in 2020 and beyond, Mr. Peikin acknowledged that initiatives of this kind require a specific set of circumstances, including perhaps a widespread practice

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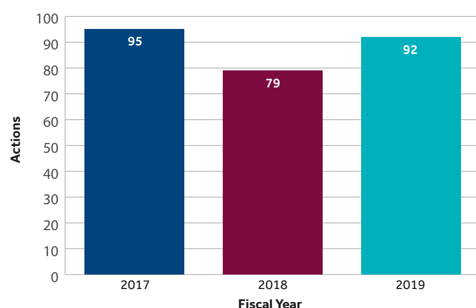
in the industry that may not be readily apparent in the near future, though he held open the possibility.

Issuer Disclosures

In fiscal year 2019, the SEC brought a number of enforcement actions against public companies alleging violations related to a wide range of disclosures, including disclosures about the companies' risk factors, accounting practices, executive compensation, and cybersecurity incidents, among other topics.

Issuer Reporting and Disclosure Enforcement Actions



Misleading Risk Factor Disclosures

A number of recently settled enforcement actions have centered on allegedly misleading risk factor disclosures in public companies' annual and quarterly reports filed with the SEC, highlighting the need for public companies to continually evaluate their risk factor disclosures and consider whether any hypothetical statements about the company's business risks could be viewed as materially misleading due to newly developed circumstances or recent events. For example, in July 2019, the SEC settled an enforcement action against Facebook, Inc. ("Facebook") alleging that Facebook misled investors about the risks it faced from misuse of user data.[2] In particular, the SEC alleged that Facebook's risk factor disclosures included in its Form 10-K and Form 10-Q filings, and incorporated by reference in its registration statements on Form S-8, presented the risk of user data as merely hypothetical when, in reality, Facebook knew that a third-party developer had actually misused Facebook user data.

Undisclosed Accounting Practices

The SEC brought a handful of enforcement actions in fiscal year 2019 alleging fraudulent revenue recognition practices, a perennial area of focus for the Division of Enforcement. Notably, in one of those cases against Marvell Technology Group, Ltd. ("Marvell"), the SEC did not allege accounting violations, but rather focused solely on the company's inadequate disclosures relating to revenue recognition.[3] In particular, the SEC alleged that Marvell failed to disclose its practice of accelerating, or "pulling in," sales scheduled for future quarters into current quarters in order to close the gap between its actual and forecasted revenues. According to the SEC order, Marvell pulled in a total of $165 million in revenues across three quarters without disclosing the impact of that practice on the company's revenues. The SEC alleged that

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Marvell's failure to disclose its use of pull-ins misled investors by: (i) giving the false impression that the company was able to meet its revenue guidance organically; (ii) masking the adverse impact that pull-ins had on revenue in future quarters; and (iii) masking the company's declining sales and market share. The SEC's settlement with Marvell serves as a reminder that compliance with GAAP will not protect a company against claims that its financial disclosures were misleading.

Undisclosed Compensation

In September 2019, the SEC entered into settlements with Nissan and its former CEO, Carlos Ghosn, for failing to disclose more than $140 million that was to be paid to Ghosn in retirement.[4] According to the SEC's order, Nissan's board of directors delegated to Ghosn the authority to set his own compensation and, pursuant to that authority, Ghosn engaged in a scheme to conceal more than $90 million from public disclosure while also increasing his retirement allowance by more than $50 million. Ghosn allegedly fixed a total amount of compensation for himself each year, but only a portion of that amount was actually paid to Ghosn and disclosed to Nissan investors. Ghosn and his subordinates then arranged to have the unpaid amounts paid to Ghosn in retirement by using secret contracts, backdating letters related to Ghosn's incentive compensation plan, and manipulating the calculation of Ghosn's pension allowance. Nissan was ordered to pay a $15 million civil penalty in connection with the settlement, and Ghosn agreed to a $1 million civil penalty and a 10-year officer and director bar.

Insufficient Cybersecurity Disclosures

Disclosure cases have also recently taken root in the cybersecurity context. After the SEC created its in-house Cyber Unit with the support of Chairman Clayton in 2017, the Commission brought several high-profile actions both against hackers and firms victimized by cyber-related incidents. Victims of cyber intrusions have found themselves subject to separate securities fraud actions where disclosures about the intrusions have been deemed insufficient. For example, in April 2018, the successor entity of Yahoo! Inc. ("Yahoo"), agreed to pay a $35 million penalty to settle an SEC enforcement action alleging that Yahoo failed to disclose that it had suffered a significant data breach of 500 million user accounts that exposed personal information.[5] At the time, this breach was the largest known theft of user data. Similar to the SEC's theory in the Facebook action, the settled order against Yahoo found that the company's risk factor disclosures from 2014 through 2016 were materially misleading because Yahoo had only disclosed the risk of potential future data breaches and related litigation and liability, rather than the fact that a massive data breach had already occurred.

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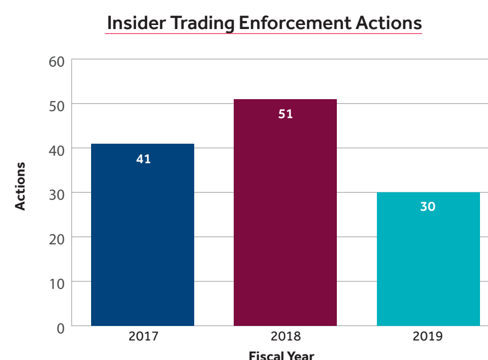
Associate Director Carolyn Welshhans indicated at the 2019 Securities Enforcement Forum in Washington, D.C. that disclosures relating to cyber-related issues would continue to be a focus within the Division, and that a long-term strategy of nondisclosure, even in spite of the existence of an ongoing investigation, would likely be viewed unfavorably. The SEC will look to companies' accounting controls, and policies and procedures, as well as to communications and disclosures to the market, when determining the appropriateness of an action related to insufficient cyber-related disclosures.

Insider Trading

Insider trading constituted roughly 6% of the SEC's enforcement docket in fiscal 2019, down from 10% a year ago. The statistics, however, do not necessarily signal a change in the Commission's appetite to enforce insider trading law where appropriate. This year, the SEC brought insider trading actions against an analyst at an investment bank, insiders at two pharmaceutical companies, a software executive, a senior attorney at a publicly traded company, and an IT contractor based in Singapore, among others. In other words, respondents and defendants spanned a wide range of industries, career roles, and geography.

During the recent Securities Enforcement Forum in Washington, D.C., the SEC staff highlighted trends in insider trading, which included data-based selection and analysis of potential cases — 20% of referrals are now generated by the market abuse unit — which is consistent with the increasingly technology-based approach to insider trading detection and prosecution. In particular, a new tool known as "Artemis" will purportedly be increasingly utilized to map, capture, and prosecute ever more complex insider trading rings, though the SEC declined to state how much the software had been used in the prior 12-month period.

Of particular note was the continued focus on gatekeepers, who find themselves subject to scrutiny by the Commission, particularly in the insider trading context. See "Focus on Gatekeepers in Recent Insider Trading Enforcement" above. The Commission is heavily focused on egregious violations and recidivist offenders, and commits substantial resources towards pursuing approximately 40% of its insider trading docket through litigation, two cases of which were tried to a jury verdict in fiscal 2019. Twenty percent of its docket reflected parallel criminal charges from the DOJ.



New York Supreme Court Rules Against NYAG in ExxonMobil Climate Change Case

On December 10, 2019, the trial-level Supreme Court of the State of New York, New York County, ruled that the New York Attorney General ("NYAG") had failed to prove that Exxon Mobil Corporation misled shareholders over the true cost of climate change.[1] The ruling followed 12 days of trial and testimony following three and a half years of investigation by the NYAG and pre-trial discovery. Finding that the NYAG had "failed to prove, by a preponderance of the evidence, that ExxonMobil made any material misstatements or omissions about its practices and procedures that misled any reasonable investor," the Court concluded that ExxonMobil had not violated the Martin Act and Executive Law § 63(12) or engaged in equitable or common law fraud and dismissed the NYAG's action with prejudice.

Notes

Proposed Legislation to Establish a Uniform Insider Trading Standard Gains Momentum in Congress

1. 17 C.F.R. § 240.10b5-1 (2019).
2. Republicans on the Committee did not support the legislation as passed by the House Financial Services Committee due to its ambiguities, failure to achieve a singular prohibition on insider trading as drafted, and its elimination of the personal benefit test entirely from the body of law in this area. H.R. Rep. No. 116-219, at 26-28 (2019).
3. 773 F.3d 438 (2d Cir. 2014).
4. The McHenry amendment also modified the original Hines bill by specifying that the MNPI regarding the market for a security, security-based swap, or security-based swap agreement that forms the second basis of liability in sections (a) and (b) of the legislation is limited to "any nonpublic information from whatever source, that has, or would reasonably be expected to have, a material effect on the market price" of any such security (whereas the Hines bill provided for such liability based upon any such MNPI "relating to the market for such security"). Rep. McHenry stated on the House floor that the purpose of this change was to clarify ambiguities, as "the phrase 'relating to the market' is not a legal term of art defined within the existing body of insider trading law, nor is it defined in this bill." 165 Cong. Rec. H9276 (daily ed. Dec. 5, 2019) (statement of Rep. McHenry).
5. An amendment proposed by Bill Huizenga (R-M.I.), which would have limited insider trading liability under the Act to the wrongful *use* of MNPI, as opposed to trading or communicating while *aware of* such information, was rejected by the House. 165 Cong. Rec. 194, H9276 (daily ed. Dec. 5, 2019).
6. 165 Cong. Rec. 194, H9274 (daily ed. Dec. 5, 2019) (statement of Rep. McHenry).
7. According to Govtrack's "prognosis" for the bill, which is provided by Skopos Labs, an automated predictive intelligence service. Govtrack, https://www.govtrack.us/congress/bills/116/hr2534 (last visited Dec. 10, 2019).
8. A Himes spokesperson told Law360 that Senate Republicans have shown interest in the bill but did not identify a sponsor who could shepherd the measure through the upper chamber." Andrew Kragie & Jody Godoy, *House Passes 1st Explicit Ban On Insider Trading*, Law360 (Dec. 5, 2019), https://www.law360.com/securities/articles/1225615/house-passes-1st-explicit-ban-on-insider-trading?nl_pk=c2930e9a-7a7c-4029-b046-7a9e5541a5d6&utm_source=newsletter&utm_medium=email&utm_campaign=securities.

U.S. Supreme Court Affirms 10b-5 "Scheme" Liability but Drops Tender Offer Liability from Docket

1. *Lorenzo v. SEC*, 139 S. Ct. 1094, 1110 (2019).
2. 564 U.S. 135 (2011).
3. *Id.* at 142.
4. *Lorenzo v. SEC*, 872 F.3d 578, 589 (D.C. Cir. 2017) (quoting Rule 10b-5(a)).
5. *Id.* at 590, 592.
6. 15 U.S.C. § 78n(e) (2012). Section 14(e) provides that it is "unlawful for any person to make any untrue statement of a material fact or omit to state any material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading, or to engage in any fraudulent, deceptive, or manipulative acts or practices, in connection with any tender offer or request or invitation for tenders, or any solicitation of security holders in opposition to or in favor of any such offer, request, or invitation."
7. *Emulex Corp. et al.v. Varjabedian,* 139 S. Ct. 1407 (2019).
8. Brief for the Chamber of Commerce of the United States as Amicus Curiae Supporting Petitioners at 3, *Emulex Corp. et al. v. Varjabedian*, 139 S. Ct. 782 (2019).

Second Circuit Hears Arguments on U.S.C. Title 18 Insider Trading Prosecutions

1. *United States v. Blaszczak*, No. 18-2811 (2d Cir. 2019).
2. Press Release, Dep't of Justice, Four Defendants Convicted in Manhattan Federal Court for Stealing Confidential Government Information and Using It to Engage in Illegal Trading (May 4, 2018), https://www.justice.gov/usao-sdny/pr/four-defendants-convicted-manhattan-federal-court-stealing-confidential-government.
3. Press Release, Dep't of Justice, Four Defendants Sentenced Following Convictions at Trial for Stealing Confidential Government Information and Using It to Engage in Illegal Trading (Sept. 13, 2018), https://www.justice.gov/usao-sdny/pr/four-defendants-sentenced-following-convictions-trial-stealing-confidential-government.
4. Brief for Defendant-Appellant Robert Olan, *United States v. Blaszczak*, No. 18-2811, 2019 WL 1177546 at *26 (2d Cir. Mar. 5, 2019).

Regulations S-K & S-X: The Year in Review

1. In 2013, the SEC staff launched the Disclosure Effectiveness Initiative with a goal of improving the disclosure regime for investors and registrants. At that time, the staff published a study that recommended the SEC re-evaluate: (i) the current disclosure requirements, (ii) the location of disclosed information and (iii) the improved utilization of technology in required disclosures. Since then, the SEC has taken a number of incremental steps to update and simplify disclosure requirements.
2. FAST Act Modernization and Simplification of Regulation S-K, Release No. 33-10618 (Mar. 20, 2019), https://www.sec.gov/rules/final/2019/33-10618.pdf.
3. The SEC has proposed to revise Item 101(c) to require in the description of a registrant's business, among other things, disclosure of human capital resources, including any human capital measures or objectives that management focuses on in managing the business, to the extent such disclosures would be material to an understanding of the registrant's business.

SEC Charges Pharmaceutical Company with Regulation FD Violation

1. *In the Matter of TherapeuticsMD, Inc.*, Exchange Act Release No. 86708 (Aug. 20, 2019) http://www.sec.gov/litigation/admin/2019/34-86708.pdf.
2. Regulation FD, 17 C.F.R. § (2000).
3. See, e.g., Litigation Release, SEC Files Settled Regulation FD Charges Against Former Chief Financial Officer, Rel. No. 21222 (Sept. 24, 2009) https://www.sec.gov/litigation/litreleases/2009/lr21222.htm; *SEC v. Presstek*, No. 1:10-cv-10406 (D. Mass. Mar. 9, 2010); In the Matter of Office Depot, Exchange Act Release No. 63152 (Oct. 21, 2010), https://www.sec.gov/litigation/admin/2010/34-63152.pdf.
4. *See In the Matter of Lawrence D. Polizzotto*, Rel. No. 34-70337 (Sept. 6, 2013), https://www.sec.gov/litigation/admin/2013/34-70337.pdf.

Congressman Ensnared by Insider Trading Action

1. Press Release, Dep't. of Justice, U.S. Attorney's Office, Southern Dist. of N.Y., Congressman Christopher Collins Pleads Guilty To Insider Trading Scheme And Lying To Federal Law Enforcement Agents (Oct. 1, 2019), https://www.justice.gov/usao-sdny/pr/congressman-christopher-collins-pleads-guilty-insider-trading-scheme-and-lying-federal.

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Focus on Gatekeepers in Recent Insider Trading Enforcement

1. Press Release, Dep't of Justice, Former Director of Corporate Law at Global Technology Company Indicted for Insider Trading (Oct. 24, 2019), https://www.justice.gov/usao-nj/pr/former-director-corporate-law-global-technology-company-indicted-insider-trading; Press Release, Sec. & Exch. Comm'n, SEC Charges Former Senior Attorney at Apple with Insider Trading (Feb. 13, 2019), https://www.sec.gov/news/press-release/2019-10.
2. Litigation Release, SEC Charges Former Seaworld Associate General Counsel with Insider Trading, Release No. 24448 (Apr. 10, 2019), https://www.sec.gov/litigation/litreleases/2019/lr24448.htm.
3. *United States v. Taylor*, Indictment, S7 18 Cr. 184 (S.D.N.Y. Sept. 9, 2019), https://www.justice.gov/usao-sdny/press-release/file/1212136/download.
4. *See* In the Matter of Tai-Cheng Yang, Exchange Act Rel. No. 85525 (Apr. 5, 2019), https://www.sec.gov/litigation/admin/2019/34-85525.pdf.

SEC's Division of Enforcement Annual Report for Fiscal Year 2019 Marks End to a Busy Year

1. Press Release, Sec. & Exch. Comm'n, SEC Orders an Additional 16 Self-Reporting Advisory Firms to Pay Nearly $10 Million to Investors (Sept. 30, 2019).
2. Press Release, Sec. & Exch. Comm'n, Facebook to Pay $100 Million for Misleading Investors About the Risks It Faced from Misuse of User Data (Jul. 24, 2019), https://www.sec.gov/news/press-release/2019-140.
3. *See* In the Matter of Marvell Technology Group, Ltd., Exchange Act Release No. 86971 (Sept. 16, 2019), https://www.sec.gov/litigation/admin/2019/33-10684.pdf.
4. *See* In the Matter of Nissan Motor Co., Ltd., Exchange Act Release No. 87054 (Sept. 23, 2019), https://www.sec.gov/litigation/admin/2019/34-87054.pdf.
5. *See* In the Matter of Altaba Inc.,f/d/b/a Yahoo! Inc., Exchange Act Release No. 83096 (Apr. 24, 2018), https://www.sec.gov/litigation/admin/2018/33-10485.pdf.

New York Supreme Court Rules Against NYAG in ExxonMobil Climate Change Case

1. *People v. Exxon Mobil Corp.*, No. 452044/2018, slip op. (N.Y. Sup. Ct. 2019).

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