LATHAM & WATKINS LLP

SEC Investigations

A Guide for Public Company Directors, Officers, and In-House Counsel

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Introduction

Even public companies with a strong code of conduct, an exemplary tone at the top, robust internal controls, and a culture of compliance may face allegations of misconduct that can lead to an investigation by the Division of Enforcement of the US Securities and Exchange Commission (the SEC, the Enforcement Division, or the Commission). For a public company, the initiation of an SEC investigation can be startling to the company's board and senior management.

A company may learn of an SEC investigation from a phone call to in-house counsel from SEC staff (Staff) notifying the company that the SEC has opened an investigation. Alternatively, a document preservation notice, voluntary request, or subpoena may arrive without warning. At other times, a company may learn about the investigation from a third party, such as its auditors, a vendor, or a customer that receives a subpoena or request for information. An SEC investigation often arrives without warning, and public companies should be prepared to respond to the investigation swiftly and with strategic foresight. The decisions made at the outset are frequently critical, will impact how the investigation unfolds, and can shape the investigation's ultimate outcome.

Competently navigating the investigative process from the beginning is imperative and can help a company avoid an enforcement action or otherwise minimize potential sanctions, while allowing senior management to focus on operating the company's business.

This Guide is a resource for public company executives and in-house counsel facing an investigation by the Commission. Competently navigating the investigative process from the beginning is imperative and can help a company avoid an enforcement action or otherwise minimize potential sanctions, while allowing senior management to focus on operating the company's business.

This Guide outlines important initial considerations for public companies contacted by the SEC, including:

- Retaining outside counsel, and protecting the attorney-client privilege and work-product protections
- Determining what conduct the SEC is concerned about, whether that conduct is ongoing, and whether prompt remediation is necessary
- Determining which internal stakeholders need to know about a possible investigation, including management, the Audit Committee, and the Board of Directors
- Determining whether and when to brief the company's independent auditors
- Preserving and collecting relevant documents
- Determining how and when to engage with the Staff
- Determining whether to notify the company's insurance carriers
- Determining whether any individuals will need separate counsel and the company's indemnification obligations
- Assessing whether to publicly disclose the investigation and the need for a public relations strategy
- Considering the likelihood and impact of a parallel criminal investigation, regulatory proceedings, or civil litigation

Understanding the investigative process and how the investigation may unfold, including internal best practices and Staff processes, is particularly important so that in-house counsel can educate business leaders. Managing expectations is also critical to avoid surprising senior management and boards. Informed in-house counsel can educate the company's management and board effectively about how an investigation could develop, helping to set expectations and minimize unhelpful surprises and disappointments over the course of the investigation, which could be lengthy. Indeed, a quick phone call to the Commission explaining that their concerns must stem from a fundamental misunderstanding of the business or the facts is almost never the right approach, and there is little chance it will resolve the Staff's concerns. Similarly, attempting to contact members of Congress, SEC Commissioners, or other senior SEC officials to foreclose an investigation is not likely to be successful.

Not all investigations will run the full course described in this Guide. However, this Guide identifies important considerations for in-house counsel, company officers, and directors when outlining the company's strategy, while keeping in mind the goal of concluding the investigation as quickly as possible with minimal disruption to the company and its officers, directors, and employees.

Origins of SEC Investigations

The SEC begins investigations for a variety of reasons. The Staff regularly monitors the financial markets, the internet, company filings, and news stories for information indicating that a violation of the federal securities laws may have occurred. The SEC has a Financial Reporting and Audit Task Force dedicated specifically to detecting fraudulent or improper financial reporting.[1] As part of that effort, the SEC has made a significant investment in tools and personnel to engage in data analysis to proactively identify potential fraudulent activity. One example of that effort is the Corporate Issuer Risk Assessment Program, also known as CIRA, which purportedly "assists the staff in detecting anomalous patterns in financial statements that may warrant additional inquiry."[2]

The Enforcement Division also obtains referrals from other SEC divisions, such as the Division of Corporation Finance, federal and state government agencies (including criminal law enforcement), the Public Company Accounting Oversight Board (PCAOB), and self-regulatory organizations like the Financial Industry Regulatory Authority (FINRA), which routinely monitors trading, news releases, and M&A activity and which makes inquiries and referrals to the SEC as a matter of course.

Public companies may also self-report potentially improper conduct to the Staff. Self-reporting may occur because public disclosure of the underlying conduct is required (as with a financial restatement), because a company believes the Staff will likely learn about the conduct through other means, or simply because the company's board and senior management believe that self-reporting is consistent with good corporate governance. Self-reporting may be required as a consequence of a prior government settlement or plea agreement, deferred or non-prosecution agreement, or similar agreement. Obviously, public companies should make the decision whether to self-report carefully.

The SEC also maintains an internal database, known as the TCR (Tips, Complaints, Reports) System, which records information received from (i) the Whistleblower Section of the SEC website, (ii) more traditional sources like phone calls and letters, and (iii) referrals from other agencies. Any such information, regardless of its source, can be grounds for an investigation. The Enforcement Division does not need probable or reasonable cause to launch an investigation, public companies do not have judicial remedies for challenging the Staff's decision to open an investigation, and the Staff has broad discretion in the conduct of an investigation. Occasionally, particularly if conduct outside the US is involved, the SEC may ask a company to investigate internally and report back before pursuing SEC investigative processes.

SEC Whistleblower Program

Relatedly, the SEC's whistleblower program is a significant driver of enforcement investigations and actions. Section 21F of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank) provides for a whistleblower program offering financial incentives for a person to voluntarily provide to the Commission non-public information that results in an enforcement action. Specifically, any resulting enforcement action that results in monetary sanctions in excess of $1 million[3] makes the whistleblower eligible for an award of 10%-30% of the aggregate monies any US regulator receives.[4]

By the end of FY 2022, the SEC had paid more than $1.3 billion to 328 whistleblowers since whistleblower rules went into effect in August 2011, resulting in orders for more than $6.3 billion in total monetary sanctions, including more than $4.0 billion in disgorgement of ill-gotten gains and interest.[5] In FY 2022, the Commission paid approximately $229 million in whistleblower awards to 103 individuals.[6] Although the dollar amount and number of award recipients decreased from record 2021 levels, the Commission paid a larger dollar amount in whistleblower awards in both 2021 and 2022, individually, than in all years prior to 2021 combined. It also paid more recipients in 2021 and 2022, individually, than in all years prior to 2021 combined.[7] Moreover, in 2022, the Commission received over 12,300 whistleblower tips — the largest number of whistleblower tips received in a fiscal year.[8]

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On September 23, 2020, the Commission adopted Whistleblower Rule Amendments, which became effective on December 7, 2020. Certain of the rule amendments increased efficiencies around the review and processing of whistleblower award claims. For example, the Commission adopted:

- A presumption setting awards at the maximum 30% of the monetary sanctions collected for awards under $5 million, which is applicable in the majority of cases, including 90% of the awards in FY 2022;[9]
- a new summary disposition process for straightforward denials that has allowed the Office of the Whistleblower to provide an initial response to claimants on their award claims more quickly; and
- a provision by which claimants who submit three or more frivolous award claims may be permanently barred from the Commission's whistleblower program.

The Whistleblower Rule Amendments also provide the Commission with authority to make awards to meritorious whistleblowers for their efforts and contributions to additional types of successful actions. For example, the Commission may treat deferred prosecution agreements and non-prosecution agreements entered into by the Department of Justice (DOJ) as "related actions" for which a whistleblower may receive an award.

In August 2022, the Commission adopted two further amendments to its rules governing its whistleblower program: "The first rule change allows the Commission to pay whistleblowers for their information and assistance in connection with non-SEC actions in additional circumstances. The second rule affirms the Commission's authority to consider the dollar amount of a potential award for the limited purpose of increasing an award but not to lower an award."[10] More specifically, the first rule change amended Rule 21F-3 to allow the Commission to pay "related action awards" if another entity's whistleblower program "is not comparable to the Commission's program or the maximum award that the Commission could pay on the related action would not exceed $5 million."[11]

The Commission can also take legal action against employers for retaliating against or impeding whistleblowers, and public companies should be aware that the Commission broadly construes the anti-retaliation provisions of the whistleblower rules. For example, in a March 2022 enforcement action, the Commission charged the respondent with violating Rule 21F-17 by impeding employees from contacting the Commission, as language in the respondent's compliance manual and training materials prohibited an employee from contacting any regulator without prior approval from the respondent's legal or compliance department.[12] Likewise, in a February 2021 action, the Commission included a Rule 21F-17 charge against a respondent for impeding individuals from contacting the Commission, alleging that certain confidentiality and separation agreements with the respondent prohibited individuals from contacting the Commission about potential securities law violations.[13] As of the end of FY 2022, the Commission has brought 16 enforcement actions or administrative proceedings involving violations of Rule 21F-17.[14]

In addition, Section 21F includes an anti-retaliation provision, which establishes a private cause of action for a whistleblower to sue their employer in federal court for any form of harassment that the employee's whistleblowing activity causes.

Trends in SEC Enforcement

Public company reporting and disclosure has always been an area of focus for the SEC, but the Commission continues to prioritize new areas as markets evolve. SEC Chair Gary Gensler and the Staff have promoted an aggressive, ambitious agenda with a new set of priorities. For example, the Commission has increased its focus on:

- Climate and environmental, social, and governance (ESG),[15] for which the SEC announced a Task Force in March 2021[16]
- Financial reporting, including, loss contingencies and recording accruals[17]
- Digital assets, for which the SEC has charged entities and individuals with unregistered and/or fraudulent offerings of digital asset securities.[18] Indeed, in May 2022, the SEC announced that it would add 20 positions to its Crypto Assets and Cyber Unit, nearly doubling its staff[19]
- Cybersecurity,[20] for which the SEC has charged entities with deficient cybersecurity procedures,[21] cybersecurity disclosure controls failures,[22] and misleading investors about breaches in cybersecurity[23]
- Market integrity,[24] for which the SEC has charged indices for failures related to quality control,[25] a credit agency for disclosure and internal control violations,[26] and an investment platform for misleading customers about revenue[27]
- Special purpose acquisition corporation (SPAC) transactions[28]
- Private equity and hedge fund fees[29]
- Record-keeping violations[30]

Moreover, the Commission has begun to more aggressively target gatekeepers for liability, including attorneys,[31] auditors,[32] and other gatekeepers for their roles in alleged financial misconduct.[33] Likewise, the SEC has continued to aggressively investigate and charge individuals in enforcement actions, and to pursue officer and director bars as viable remedies against them.[34] In FY 2021 and FY 2022, for example, more than two-thirds of newly filed enforcement actions involved at least one individual defendant or respondent.[35]

Summary of Potentially Applicable Statutes

SEC investigations are authorized by various federal securities statutes and are governed by the rules provided in 17 C.F.R. § 202.5, the Enforcement Division's *Enforcement Manual*, and other Commission guidance. Investigations may be formal or informal.[36] In a preliminary inquiry, also known as a Matter Under Inquiry (MUI), or in an informal investigation, the Staff does not have the power to subpoena companies or individuals, and relies on the voluntary cooperation of those from whom information is sought.[37] In a formal investigation, the Staff obtains a formal order of investigation, which authorizes the Staff to issue subpoenas that could require the recipient to produce documents or provide testimony.[38] The formal order is not publicly available, but persons asked to produce documents or testify before the Commission can request it.

The Staff states consistently that SEC investigations aim to determine whether securities law violations occurred. In correspondence related to the investigation (e.g., document requests and subpoenas), the Staff frequently notes that the existence of an investigation should not be "construed as an indication that the Commission or the Staff have a negative view of any entity, individual or security" or words to that effect. The existence of an investigation does not mean that the Staff will necessarily recommend an enforcement action to the Commission. Instead, the investigation means that the Staff has identified an issue that it believes warrants investigative resources. At any stage of the investigation, the Staff can and does close investigations without enforcement action.

Numerous federal statutes may be at issue in an SEC investigation. The principle federal securities statutes likely to be involved in an SEC investigation involving public company accounting and disclosures are discussed below. Note that other statutes may be involved in parallel investigations, particularly criminal investigations.

The Anti-Fraud Provisions

Section 10(b) of the Securities Exchange Act of 1934 (Exchange Act) and Rule 10b-5 thereunder prohibit fraudulent conduct "in connection with the purchase or sale of any security."[39] Section 17(a) of the Securities Act of 1933 (Securities Act) prohibits fraudulent conduct "in the offer or sale of any securities."[40] These are the two catchall anti-fraud provisions most frequently brought by the SEC that generally apply to misstated financial statements and related false or misleading disclosures by public companies.[41]

Section 17(a)(1) of the Securities Act, Section 10(b) of the Exchange Act, and Rule 10b-5 require a showing of scienter,[42] which is satisfied by a showing of willful misconduct or recklessness.[43] By contrast, Sections 17(a)(2) and 17(a)(3) of the Securities Act do not require a showing of scienter.[44] Those two provisions make it unlawful, in the offer or sale of any securities using jurisdictional means, "to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading" or "to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser."[45]

In more serious cases, and consistent with its focus on the inclusion of individual charges, the Commission has included charges of "control person" liability under Section 20(a) of the Exchange Act,[46] "aiding and abetting" liability under Section 20(e) of the Exchange Act,[47] and/or "causing" liability under Section 21C(a) of the Exchange Act.[48] Both "control person" liability and "aiding and abetting" liability require a showing of scienter. Scienter for "control person" liability can be satisfied by a showing of "culpable participation or knowledge."[49] Scienter for "aiding and abetting" liability requires a showing of knowledge of the primary violation *or* recklessness.[50] For "causing" liability, the mental state depends on the primary violation: if scienter is a required element of the primary violation, "causing" liability requires scienter; if the primary violation does not require scienter, negligence is sufficient.[51]

The Foreign Corrupt Practices Act Anti-Bribery Provision

Section 30A of the Exchange Act, the anti-bribery provision of the Foreign Corrupt Practices Act (FCPA), prohibits bribing "foreign officials" to obtain or retain business.[52]

Section 30A applies to "issuers" — companies with a class of securities registered under Section 12 of the Exchange Act or companies that are required to file periodic or other reports with the SEC.[53] Foreign companies with American Depository Receipts (ADRs) that are listed on a US exchange are also subject to Section 30A.[54] In addition, officers, directors, employees, agents or stockholders acting on behalf of the issuer can also be charged with violations of Section 30A.[55]

Section 30A specifically makes it unlawful, subject to US jurisdiction, to "corruptly in furtherance of an offer, payment, promise to pay, or authorization of the payment of any money, or offer, gift, promise to give, or authorization of the giving of anything of value" to (a) a foreign official, (b) foreign political party or foreign political party official, or (c) any person, while knowing that all or a portion of such money or thing of value will be offered, given, or promised, directly or indirectly," to (a) or (b), for the purposes of "(i) influencing any act or decision of such official in his official capacity; (ii) inducing such foreign official to do or omit to do any act in violation of the lawful duty of such official, or (iii) securing any improper advantage," or "inducing such foreign official to use his influence with a foreign government or instrumentality thereof to affect or influence any act or decision of such government or instrumentality," in each case "in order to assist such issuer in obtaining or retaining business for or with, or directing business to, any person."[56]

The five elements of an FCPA violation include:

- the payment of money or something of value (which the SEC interprets broadly);
- to a "foreign official" (directly or indirectly while knowing it will be provided to a foreign official);
- "corruptly" (that is, an intent to wrongfully influence the recipient);
- for a prohibited purpose outlined in the statute; and
- to obtain or retain business (which the SEC interprets broadly to include a variety of business advantages).[57]

Reporting, Books and Records, and Internal Controls

Section 13(a)(2) of the Exchange Act and Rules 13a-1 and 13a-13 thereunder require every public company to file with the Commission annual and quarterly reports.[58] The SEC and the federal courts have held that a company violates these provisions if it files annual or quarterly reports that include financial statements that are materially misstated or that contain misstatements or omissions in the disclosure.[59] Similarly, Rule 13a-11 promulgated thereunder requires factually accurate periodic reports on Form 8-K.[60] Moreover, Rule 12b-20 requires that periodic reports contain all information necessary to ensure that statements made in those reports are not, under the circumstances, misleading.[61] No showing of scienter is necessary to establish an issuer's violation of the corporate reporting provisions, Section 13(a) of the Exchange Act and Rule 13a-1 thereunder.[62] Consequently, an issuer violates the reporting provisions if it files materially false or misleading reports or omits information necessary to render the statements not misleading.[63]

Section 13(b)(2)(A) of the Exchange Act requires a public company to make and keep books, records, and accounts, which, in reasonable detail, accurately and fairly reflect the transactions and dispositions of company assets.[64] The Exchange Act defines the term "in reasonable detail" to mean the level of detail that would "satisfy prudent officials in the conduct of their own affairs."[65] Section 13(b)(2)(B) of the Exchange Act requires a public company to devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that:

(i) transactions are executed in accordance with management's general or specific authorization;

(ii) transactions are recorded as necessary (I) to permit preparation of financial statements in conformity with generallyaccepted accounting principles . . . , and (II) to maintain accountability for assets;

(iii) access to assets is permitted only in accordance with management's general or specific authorization; and

(iv) the recorded accountability for assets is compared with the existing assets at reasonable intervals and appropriate action is taken with respect to any differences.[66]

Scienter and materiality are not elements of primary violations of either Section 13(b)(2)(A) or Section 13(b)(2)(B). Both provisions are regularly used in cases involving false or inaccurate financial statements, including in FCPA cases lacking jurisdiction to charge under Section 30A.

Likewise, Rule 13a-15 of the Exchange Act requires an issuer to establish and maintain an overall system of disclosure controls and procedures to provide reasonable assurance that the issuer is meeting its Exchange Act financial reporting obligations.[67]

Other charges are geared toward disclosure controls for individual employees. Section 13(b)(5) of the Exchange Act and Rule 13b2-1 thereunder prevent individuals from "knowingly circumvent[ing] or knowingly fail[ing] to implement a system of internal accounting controls or knowingly falsify[ing] any book, record, or account."[68] Rule 13a-14 of the Exchange Act requires an issuer's principal executive and financial officers to certify the accuracy and completeness of all information contained in the issuer's quarterly and annual reports.[69] Rule 13b2-2 of the Exchange Act forbids directors or officers of issuers from making material misstatements to accountants in connection with an audit, review, or examination of the issuer's financial statements.[70]

Investigative Process and a Public Company's Response to an SEC Investigation

Regardless of whether the investigation is formal or informal, a company under investigation should take the matter seriously from beginning to end. Any investigation can lead to an enforcement action, and the consequences can affect both a company's finances and reputation. The tone with which a company approaches an investigation may also demonstrate to the SEC that the company is earnest in its attempt to determine the relevant facts and remedy any mistakes or wrongdoing — factors that the SEC may consider when determining what charges and sanctions to seek. The key action items and considerations discussed below can aid a company subject to an SEC investigation in crafting that tone from the outset.

Retaining Outside Counsel

When a company learns of a potential SEC investigation, the company should consider retaining outside counsel with experience in SEC investigations. A company faces a multitude of complex issues and strategic decisions, and outside counsel's experience in dealing with the Staff is important. Moreover, counsel will want to be well-versed in the facts, and possibly will conduct an internal investigation in order to adequately defend a company in an SEC investigation. The Staff will be more likely to rely on a thorough review that was conducted by competent outside counsel than one, however robust, conducted by in-house counsel. Using outside counsel to conduct an investigation can minimize delays and free up in-house counsel to continue with their day-to-day responsibilities.

Further, using outside counsel to conduct an investigation can bolster the preservation of attorney-client privilege protections — which can become complicated if in-house counsel provide both legal and business advice. Using experienced and respected counsel can improve the Staff's perception of a company, as the Staff may make an adverse inference against the company if it believes counsel is employing deceptive or dilatory tactics. In matters involving the likelihood of criminal or other regulatory proceedings, and/or related civil litigation, companies should choose counsel experienced with navigating the dangerous waters of such parallel proceedings.

Public Disclosure of an SEC Investigation

> A company should consider several strategic factors when determining whether and when to disclose publicly an SEC investigation.

With limited exceptions, the SEC conducts investigations without publicly disclosing their existence, and generally does not confirm or deny publicly that it is investigating a specific company.[71] That said, the Staff may contact other individuals and companies who have relevant information about the matter, and these individuals, like the company itself, do not have a duty to keep the matter confidential. These individuals may discuss the investigation with others, including the press. If an investigation results in an enforcement action, however, the SEC will make the matter public. The SEC will publicly file pleadings and orders related to the enforcement action and, generally, will publicize the enforcement action with press releases and litigation filings published directly on the SEC's website. These press releases and filings could receive substantial media coverage.

A company should consider several strategic factors when determining whether and when to disclose publicly an SEC investigation. There is no specific line-item disclosure requirement, meaning a company must assess the materiality of the investigation, underlying conduct, potential collateral consequences, and potential outcomes before deciding whether disclosure is required. As a result, a company should carefully analyze the facts and circumstances developed during an investigation, determine how those facts affect the company's previous disclosures, and make materiality assessments. If disclosure is advisable or required, a company must decide whether to make immediate disclosure in a current report on Form 8-K or wait until the next periodic filing on Form 10-Q or Form 10-K.

A company may choose to disclose earlier than required based on a variety of strategic considerations, including whether earlier disclosure will preserve credibility with investors and analysts (and whether that credibility may be harmed by delayed disclosure), the risk of leaks, and whether the SEC may contact customers or other third parties about the investigation. Taking into account these strategic considerations — particularly if a company fully understands the scope of the potential misconduct — it may choose to disclose the existence of an investigation when the Staff first notifies the company of the investigation.

Alternatively, a company may choose not to publicly disclose an SEC investigation unless disclosure is required pursuant to a specific requirement (such as Regulation S-K).[72] In any event, a company under investigation must not falsely deny the existence of an SEC investigation. However, a company may wish to consider a policy of not commenting on the existence of an SEC investigation.

In addition to determining whether to disclose the fact of an investigation, a company should also consider whether the investigation affects any pending disclosure documents or registration statements.

Pursuant to Regulation S-K, public companies are required to provide disclosure in periodic and annual reports and registration statements concerning a number of specific items that the discovery of corporate wrongdoing may affect:

- **Item 103**, *Legal Proceedings*, requires disclosure of "pending" proceedings as well as proceedings "known to be contemplated by governmental authorities" against a corporation, subject to a materiality threshold.[73]

- **Item 303**, *Management's Discussion and Analysis of Financial Condition and Results of Operations* (MD&A), requires public companies to disclose "known trends or uncertainties that have had or that the registrant reasonably expects will have a material favorable or unfavorable impact on net sales or revenues or income from continuing operations."[74] Item 303 requires disclosure of a pending investigation only if the company "reasonably expects" the investigation to have a materially adverse effect on the company. However, over the course of an investigation management or the board may become aware of conduct, particularly improper or illegal conduct that may increase the risk of a material effect on the company.

- **Item 401(f)**, *Involvement in Certain Legal Proceedings*, requires disclosure of certain legal proceedings concerning officers, directors, and nominees that are "material to an evaluation of the ability or integrity" of that person.[75] Over the years, there has been some controversy over whether Item 401(f) (as well as Item 103) requires the disclosure of potentially illegal conduct prior to the filing of a complaint or indictment.

- **Item 503(c)**, *Risk Factors*, requires disclosure of the most significant risk factors that apply to the company in particular.[76]

Disclosure in the footnotes to a company's financial statements may be required if the company determines that the investigation constitutes a contingency with respect to which a loss is "probable" (i.e., likely to occur) or "reasonably possible" (i.e., the chance of the loss occurring is less than likely but more than remote).[77] If a loss is probable and a company can reasonably estimate the amount of the loss, the applicable accounting literature requires the company to accrue a reserve. If a loss is probable but the amount is not reasonably estimable, a company must disclose the nature of the contingency and state that it cannot estimate the amount of the loss. Similarly, if a company determines that the amount is reasonably possible but not probable, the company must disclose the nature of the contingency and an estimate of the possible loss (or the range of possible loss), or state that such an estimate cannot be made.

Determining whether an SEC investigation is a loss contingency that requires financial statement disclosure can be challenging, and companies should consult expert disclosure counsel when necessary and appropriate. When assessing whether an investigation requires financial statement disclosure, management should consider a number of factors, including the underlying facts, the posture of the investigation, the likelihood that the company will be charged (as well as likely remedies the SEC might seek), whether the company and the Staff have discussed settlement of a possible enforcement action, and whether the company has made an offer of settlement. The decision and timing of making such disclosures has been a recent area of focus by the Commission.

Finally, the CEO and CFO (and any other certifying officers) should be aware of relevant information that affects their certifications pursuant to Sections 302 and 906 of the Sarbanes-Oxley Act as to the accuracy of SEC filings, including the financial reports included in those filings.[78]

Of course, the disclosure of an investigation (as well as any evidence of possible misconduct or other negative facts) likely will result in adverse publicity and possible private litigation, such as shareholder class actions or derivative actions. Therefore, a company should instruct all employees who deal with the media on how to respond to questions from the press, analysts, and shareholders about a disclosed investigation. Any communications related to the investigation should take into account public relations considerations; concerns about releasing inaccurate or misleading statements; waivers of privilege; and Regulation Fair Disclosure (Reg FD).[79]

A company and its counsel should also consider whether and when the company should inform third parties of the investigation, including, for example, insurance carriers, lenders, customers, and other business partners.

Preserving and Producing Documents

During an investigation, the SEC often gathers information through document requests. At the beginning of any investigation, the company should take proactive steps to preserve relevant documents, which may include paper records, electronic files, and other materials. These steps should include the suspension of document destruction routines or procedures. Improper document destruction or alteration — even if inadvertent — is always a serious matter and can carry significant penalties, including fines and prison sentences.[80]

Document collection, processing, and review can be both time-consuming and expensive. Moreover, SEC document requests and subpoenas are often very broad and have unrealistic deadlines. As a result, the Staff is usually receptive to negotiating both the scope and timing of document productions. Through these negotiations, counsel may be able to extend the amount of time given for a production, limit the date range or subject matter for document requests, or even eliminate certain requests altogether. The Staff may also agree to accept production of documents on a rolling basis. Also, in the event of production delays, counsel should contact the Staff with a status update to assure them of a client's continued cooperation.

Cases involving documents in foreign jurisdictions can add a layer of complexity to an SEC investigation. Frequently, in investigations involving large productions of documents located outside the US, the Staff will rely on voluntary productions in lieu of subpoena-based requests.[81] However, in matters involving US-based public companies, the SEC can take the position that company documents located outside the US are under the custody and control of the parent. Additionally, if a US-based entity or individual refuses to produce documents located outside the US voluntarily, the SEC may attempt to use compulsory processes to obtain the documents.[82]

If blocking statutes, such as the European Union's General Data Protection Regulation (GDPR), present a potential legal barrier to compliance with an SEC document request or investigative subpoena for materials located outside the US — and the Staff believes that a company is otherwise cooperating in an investigation — the Staff can exhibit flexibility in accepting information in some form that will not violate local law. For example, the *Enforcement Manual* states that in some instances, "the company may be able to convey important information to the staff by producing interview memoranda and through reports of findings derived from otherwise restricted sources."[83]

SEC Interviews and Investigative Testimony

Witness interviews and investigative testimony (the latter of which is under oath and transcribed by a court reporter) also play an important role in the Staff's fact-gathering process. Generally, after document production is complete, the Staff may consider whether to request witness interviews or testimony from company employees. The Enforcement Division will expect that in cooperating with the investigation, a company will use its best efforts to make current employees available for testimony or interviews. However, the Staff will not likely be able to compel the appearance for testimony of non-US citizens (unless the Staff can properly serve those non-US citizens while they are in the US).

Once the Staff begins interviewing witnesses or taking investigative testimony, the order of witness testimony can become an important tactical decision. A company may be able to convince the Staff that a particular order of testimony is most likely to answer their questions in an efficient manner. This strategy may avoid a situation in which the SEC feels the need to go back to earlier witnesses based on the more expansive testimony of later witnesses.

If the SEC requests or subpoenas witness testimony, counsel will need to prepare witnesses to testify accurately and effectively. Witnesses have a right to be accompanied by counsel during testimony, and only counsel who represent the witness can attend investigative testimony. Witness preparation requires time and an understanding of key documents about which the SEC may ask a witness to testify. Counsel should conduct a thorough review of documents that may be relevant to the investigative issues and understand a witness' recollection of key facts. Counsel should also prepare a witness for questions the Staff is likely to ask.

Counsel should consider potential conflicts issues carefully throughout the investigation, including the need for *Upjohn* warnings to make clear to employees that counsel represents the company and is not the attorney for the individual.[84] In some circumstances, either due to conflicts or for strategic reasons, a company employee may require individual counsel separate from counsel representing the company. The Staff is particularly sensitive to counsel representing multiple witnesses whom the Staff suspects to have adverse interests.[85] If employees require separate counsel, the company will also need to assess its advancement and indemnification obligations under governing documents. Where not mandatory, the company should consider the value of voluntary advancement and indemnification to ensure the employees have qualified counsel to represent their interests.

If separate representation is not necessary, joint representation can limit expenses and facilitate the sharing of information. To the extent individuals retain separate counsel, the company should explore the feasibility of common interest agreements, which can facilitate sharing privileged information between parties while maintaining the confidentiality of privileged communications. If entering into an agreement, counsel should consider whether the agreement should be oral or written and the obligations placed on the company. Indeed, common interest agreements are not without risk and can restrict the use of information obtained from another party even when disclosing that information may be advantageous.

The Fifth Amendment privilege against self-incrimination is available to individuals throughout an SEC investigation and civil enforcement action. Whether an individual asserts the privilege will be the decision of the individual with advice from their counsel, but this can have significant ramifications for the company in both the SEC investigation and in related civil litigation — particularly if a senior executive makes the assertion. The Commission can draw an adverse inference from an individual's assertion of the right (against the individual and possibly the company) in deciding whether to proceed with an enforcement action, and may move the court to do the same in subsequent enforcement proceedings.[86]

Cooperation With the Staff

Since 2001, when the SEC released its *Seaboard Report*[87] outlining considerations for the Commission in evaluating whether a public company would receive credit in the form of reduced charges or sanctions for "self-policing, self-reporting, remediation and cooperation," the SEC has emphasized the importance of a public company's cooperation in an SEC investigation. The SEC website highlights the Enforcement Cooperation Program and the benefits of cooperation.[88] Depending on the level of cooperation, the benefits may be significant. The SEC has been willing to agree to cease-and-desist orders, deferred prosecution agreements, non-prosecution agreements, and even "full passes" if the respondent substantially cooperated with the investigation. In most instances, though, to the extent the Commission rewards cooperation, it is through the reduction of charges, penalties, or other sanctions that the Staff would otherwise have pursued. Whether — and how — to cooperate is a judgment each company must make.

The *Seaboard Report* set forth a non-exclusive list of criteria for the Staff to consider "in determining whether, and how much, to credit self-policing, self-reporting, remediation and cooperation" while maintaining "broad discretion to evaluate every case individually, on its own particular facts and circumstances."[89] The *Seaboard Report* includes the following questions, among others, relating to these considerations:

- How did the company cooperate with the Staff's investigation?
- What compliance procedures were in place to prevent the misconduct now uncovered?
- How was the misconduct detected and who uncovered it? Did the company report the misconduct to the SEC, or did the SEC know about the problem before hearing from the company?
- What steps did the company take upon learning of the misconduct?
- What assurances are there that the conduct is unlikely to recur?[90]

In January 2010, as part of a broad effort to further encourage cooperation by individuals and companies, the SEC updated the *Enforcement Manual* to address how to measure and reward cooperation by individuals and public companies.[91] In addition to encompassing the principles initially laid out in the *Seaboard Report*, the *Enforcement Manual* now identifies a "non-exclusive" list of tools for "facilitating and rewarding cooperation," including proffer agreements, cooperation agreements, deferred prosecution agreements, non-prosecution agreements, and immunity requests.[92] These incentives (along with the whistleblower rewards available to individuals) can impact whether and to what degree public companies and individuals cooperate with the SEC.

Additionally, the SEC administration, led by Director Gurbir Grewal, has stated that obtaining credit for cooperating with the Staff requires more than merely responding to subpoenas and making witnesses available for testimony.[93] In SEC speeches and press releases, Director Grewal has discussed the types of cooperation the Commission has tended to credit.[94] In practice, however, the SEC has resisted quantifying the benefits of cooperation in settlement negotiations, in contrast to the DOJ, for example, in its FCPA Corporate Enforcement Policy.

A company should remember that cooperation does not preclude counsel from negotiating with the Staff regarding its requests for documents and testimony or from vigorously advocating for the company. Counsel should approach these negotiations with the goal of maintaining a running dialogue with the Staff to understand what it is specifically seeking and to determine how counsel — mindful of the burdens of the Staff's request and impact on a company — can provide the Staff with the requested information. At the same time, counsel must approach negotiations carefully and strategically. Counsel's credibility plays a major factor in the Staff's perception of the client during an investigation, and the Staff may make an adverse inference against the client if the Staff believes counsel is employing dilatory tactics.

A company should remember that cooperation does not preclude counsel from negotiating with the Staff regarding its requests for documents and testimony or from vigorously advocating for the company.

Cooperating earlier during the investigation may pay dividends during the Wells process (discussed below) because the Staff will consider it as one factor in determining whether to allow the party access to the Staff's non-privileged investigative files, which in turn can aid counsel in crafting a persuasive and effective Wells submission.[95]

Attorney-Client Privilege and Attorney Work-Product Considerations

In the *Seaboard Report*, the Commission identified voluntary disclosure of investigative findings as a factor to consider in determining a company's cooperation credit, but acknowledged that public companies need not waive the attorney-client privilege, work-product protection, or other privileges in order to receive credit. The *Enforcement Manual* codifies the Staff's approach:

> *"Voluntary disclosure of information need not include a waiver of privilege to be an effective form of cooperation and a party's decision to assert a legitimate claim of privilege will not negatively affect their claim to credit for cooperation. However . . . if a party seeks cooperation credit for timely disclosure of relevant facts, the party must disclose all such facts within the party's knowledge."*[96]

Deciding to share privileged materials with the SEC is a significant decision with serious potential consequences. Voluntary disclosure to an independent third party that lacks a common legal interest generally waives the attorney-client privilege, even if the third party agrees not to disclose the communications to anyone else.[97] Most courts have held that a company's disclosure of privileged materials to the SEC waives the attorney-client privilege.[98] And if the attorney-client privilege is waived to the SEC, that waiver would generally include a waiver as to other third parties, including potential civil litigants or the DOJ. A waiver with respect to specific documents or information would also likely extend to all other communications related to the same subject matter as the disclosed communications.[99] Similarly, disclosure of materials protected by work-product protections to the SEC likely would also constitute a waiver of that protection.[100] Attorney work-product protections are waived when otherwise protected documents are either made available to an adversary, or to a third party that could serve as a conduit to an adversary.[101]

Companies have often attempted to navigate the line between obtaining cooperation credit without waiving privilege by providing the Commission with oral downloads of non-privileged facts obtained from investigation interviews. A number of cases have demonstrated that this approach is not without risk, as courts have concluded in certain cases that such downloads can result in a waiver of privilege and require production of otherwise privileged interview memoranda, notes, summaries, and other related documents.[102]

Moreover, even if the producing party and the SEC sign a confidentiality agreement, it is likely that disclosure will waive work-product protections and the attorney-client privilege, as most Courts of Appeal have uniformly rejected the argument that a producing party can preserve the attorney-client privilege and work-product protection as to documents produced to an adverse government agency through use of a confidentiality agreement.[103] As a result, companies must carefully consider the documents that they voluntarily produce to the SEC, balancing the benefits of cooperation with the risk of waiving attorney work-product protections.

Keeping a Company's Independent Auditors Informed

Appropriately informing a company's independent auditors of the investigation, its progress, and key facts is one of the most important action items for a company in an SEC investigation. When the SEC is investigating, keeping the company's independent auditors in the dark is almost never advisable. In an SEC accounting investigation, the independent auditors will be concerned about a number of issues, including the accuracy of the company's financial statements (and whether a restatement may be necessary), whether they can continue to rely on representations received from management, and whether their prior audits may become a subject of the investigation. Indeed, to the extent the SEC's investigation is accounting-related, the independent auditors likely will receive a request for documents and possibly investigative testimony. Keeping the auditors up to date will help facilitate the investigation and ensure, to the extent practicable, that the company is able to continue to issue audited financial statements.

Working with the auditors, however, raises privilege and work-product questions that require a careful balancing of the need to keep the auditors informed while maintaining a company's privileges. Just as with disclosure to the SEC, courts have typically held that disclosure of attorney-client privileged information by a company to its independent auditors constitutes waiver of the privilege.[104] However, courts have generally held that sharing work product with auditors does not waive work-product protections because the auditors are neither the company's adversaries nor a conduit to the company's adversaries.[105]

To the extent a company is also conducting an internal investigation, auditors often make substantive suggestions regarding the scope of document collection, search terms, investigative interviews, and fact-finding. In an investigation, independent auditors may also request:

- details of the document collection and data processing;
- search terms for identifying relevant documents;
- interview lists;
- key documents;
- detailed briefing on facts from the document review and investigative interviews a company has conducted (including any internal investigations conducted by the board of directors or a board committee); and
- in certain cases, the ability to conduct their own interviews.

A company can minimize the risk of delay in the investigation by finding a way to provide such information to the company's independent auditors to ensure their comfort with the investigation process, while being mindful of the privilege and work-product risks.

Considering the Impact of Parallel Civil Litigation and Other Government Investigations

Decisions about sharing privileged information or work product should take into account the risk of parallel litigation and other regulatory investigations. When disclosure of an investigation, or the conduct that triggered the investigation (e.g., a financial restatement), causes a stock drop, shareholder class action litigation will almost surely follow. Such cases can generate significant potential damages. Less serious, but even more common, are shareholder derivative suits. These suits, purportedly brought in the name of the corporation, do not require any stock drop. Instead, the plaintiffs' lawyers contend a company should sue its own officers or directors for causing the alleged misconduct that triggered an SEC investigation. In addition, other regulators of the company may also launch investigations into the same conduct.

A company must be aware that waivers of privilege and work-product protections in one context are generally waivers as to all contexts. It is important to make strategic decisions with that risk in mind. What may help in one forum can have serious adverse consequences in another. For example, detailed written presentations or PowerPoint slides provided to the SEC on the facts of a case may win SEC cooperation credit and could shorten the time of the SEC investigation. But the same presentation — if produced in collateral civil litigation — could provide plaintiffs' lawyers with a road map to the worst facts and raise the settlement value of the civil litigation. A company weighing privilege waivers must assess the risks and benefits across the spectrum of actual and potential related matters.

Remediation

When a company learns of potentially problematic conduct, the company should take immediate steps to ensure that no improper or illegal conduct is ongoing and to remedy any mistakes in financial statements. The SEC considers appropriate remediation to be a key element of cooperation, and prompt and meaningful remediation can impact whether there is an enforcement action and the scope of the sanctions.

Any remediation plan should be robust and demonstrate to the SEC the company's desire to fix any problems that occurred.[106] Remediation can include personnel actions, and often does if there has been some wrongdoing. Remediation may also include management's assessment of any internal control deficiencies, and management's and the board's plans to remedy any deficiencies to prevent the issues from repeating.[107]

In the event of a financial restatement, remediation may also require a company to consider the need to "claw back" certain executive compensation, even if an executive was not involved in misconduct. The SEC may pursue clawbacks under either Section 304 of the Sarbanes-Oxley Act or Section 954 of Dodd-Frank. Section 304 empowers the SEC to recover certain restatement-related compensation and stock profits from CEOs and CFOs of public companies in the event that misconduct caused the restatement. In *SEC v. Jensen*, a unanimous Ninth Circuit panel held that Section 304 allows the SEC to seek a clawback "regardless of whether a restatement was caused by the personal misconduct of an issuer's CEO or CFO or by other issuer misconduct."[108] In other words, the SEC may pursue executive compensation clawback even if the executive had no role in causing the need for a restatement. Section 954 also addresses clawbacks in the event of a restatement. Section 954 applies to all current and former "executive officers" — not just the CEO and CFO — and puts the onus on a company to claw back incentive-based compensation in excess of what an executive officer would have received with accurate financials. In addition, while Section 304 is limited to restatements caused by misconduct, Section 954 contains no such limitation. The SEC adopted final rules implementing Section 954 on October 26, 2022.[109]

Resolving the Investigation

General

Favorable resolutions come in many forms. Closing an investigation quickly without any charges, and with minimal disruption to a company's business, is the most desirable outcome — and that does occur. Even if an investigation is extended, a Staff decision to close the investigation without action is still a good outcome. If, following an investigation and Wells process, the Staff is determined to move forward with an enforcement recommendation, a company can still negotiate the violations charged and the relief obtained in a way that may be more favorable than a litigated outcome.

Timing

As noted, the duration of an SEC investigation can be quite lengthy and difficult to predict. Typical investigations related to financial disclosures (to the extent such generalizations can be made) frequently take at least one year, and often take two or more years. Investigations lasting five years or even longer are not unheard of. The Staff has worked to expedite the process by (i) cutting back on meetings between the Staff and entities and (ii) asking entities to produce documents and respond to requests more rapidly.[110] A company can also attempt to expedite the investigation by responding to investigation demands promptly and proactively, as well as by crafting a strategy involving internal fact-gathering and legal argument to respond to the Staff's concerns.

Defending and cooperating with an SEC investigation can therefore be costly, and leaving an investigation unresolved prolongs uncertainty in the capital markets — which is especially costly for a company that issues securities. A lengthy investigation can also cause broader reputational harm. If a company believes that a response to a Wells notice will not be persuasive or that an enforcement action is inevitable, the company should consider an attempt to resolve the SEC matter as quickly as possible, assuming a reasonable settlement can be reached. Even if a company seeks to settle, the Staff might refuse to enter into serious settlement negotiations prior to investigating the conduct of senior officers or potentially implicated board members, because determining the level of individuals' culpability may impact the level of a company's culpability, and also because, as noted, the SEC has begun to more aggressively charge individuals in enforcement actions.

The Wells Process and Settlement Negotiations

The process by which the Staff ends an investigation is a flexible one. In theory, in a case that lends itself to enforcement action, the Staff continues to investigate and analyze the issues until it tentatively concludes that it will recommend to the Commission that it take enforcement action against a particular party. At that point, the Staff makes a Wells call — a formal notice of the Staff's intended recommendation — and provides the party with an opportunity to respond in writing.[111] After receiving a Wells call, counsel typically meets with the Staff to learn the Staff's position and the possible enforcement recommendation. At this point, a company is entitled to make a Wells submission to the SEC, stating its position and presenting arguments as to why the Commissioners should reject the Staff's recommendation for enforcement, or bring lesser charges; for example, resolving a case as a reporting violation under Section 13(a)(2) rather than under the anti-fraud provisions.[112] Indeed, the Wells submission is generally a company's only opportunity to make a direct approach to the Commission. After providing the Staff a Wells submission, counsel often meets with senior members of the Enforcement Division who did not personally participate in the investigation to make the case for why the Staff should reconsider its recommendation.

The Wells notice does not necessarily indicate that charges will be filed. As one court has noted, "[t]he Wells process was implemented so that the Commission would have the opportunity to hear a defendant's arguments before deciding whether to go forward with enforcement proceedings."[113]

Informally, however, a party that thinks the Staff does not fully appreciate the strength of its position, or a party that believes that a Wells call is inevitable but settlement is possible, need not, and generally should not, wait for a Wells call before contacting the Staff to discuss the relative strengths of their positions and about settlement. And in many cases, the Staff may make inquiries regarding the possibility of settlement before making a formal Wells call.

If the Staff proceeds with recommending an enforcement action after the Wells notice and a company's Wells submission, the Staff will submit a memorandum to the Commission setting forth its recommendation along with the Wells submission. The Commissioners will then conduct a vote to decide whether to institute an enforcement action based on this recommendation, which requires majority approval.

Settlement vs. Litigation

Public companies often opt to settle rather than litigate SEC cases involving allegations that the company misstated their financial condition for a number of reasons beyond the costs of litigation.

First, adverse findings in litigated proceedings are generally binding in private shareholder litigation. Additionally, the SEC permits parties to settle without admitting the Commission's allegations or findings of wrongdoing so long as the parties also do not deny the allegations or findings — although, as discussed below, in some instances the SEC may insist on an admission. Finally, settling parties can often influence the way the SEC describes the alleged misconduct. In cases of good cooperation and remediation, settling parties can sometimes arrange for positive mention in the Commission's public releases of a company's cooperation with the SEC's investigation and of remedial measures a company has undertaken.

By contrast, individuals tend to have a different calculus and litigate more frequently against the SEC.

Types of Enforcement Actions

The Commission is authorized to bring enforcement actions in two different forums:

- civil injunctive actions in federal district court; and
- administrative proceedings before the SEC's own administrative law judges.

Civil Injunctive Action

When filing an enforcement action in federal district court, the SEC will generally seek civil monetary penalties, an injunction against future violations of the federal securities laws, and other equitable remedies. A case begins with the SEC filing a complaint, which sets forth the SEC's allegations. In a settled enforcement action, along with a complaint, parties will also file the defendant's consent to the entry of the final judgment (including any sanctions and undertakings) and the final judgment to be approved by a judge. The final judgment will permanently enjoin the defendant from future violations and impose the agreed-upon sanctions. In a settled action, there are no findings of fact or conclusions of law in the final judgment. If a defendant chooses to litigate with the SEC, the defendant will submit an answer to the complaint and the case will proceed in litigation.

Administrative Proceeding

Instead of filing an action in federal district court, the Commission may decide to bring an administrative proceeding — a decision that is within the SEC's discretion. A settled administrative proceeding is typically resolved by the entry of a cease-and-desist order — similar to a federal court injunction — requiring a respondent to cease and desist from violations of the federal securities laws. A settled order will also include the Commission's findings of fact, conclusions of law, and sanctions imposed.

The SEC has frequently turned to administrative proceedings in litigated matters.[114] In FY 2021, for example, about 48% of the actions brought by the SEC were in stand-alone administrative proceedings.[115] These in-house tribunals, which SEC-employed administrative law judges preside over, operate faster and with less discovery than a federal court proceeding. The use of administrative proceedings has garnered both widespread publicity and constitutional challenges.[116] On July 13, 2016, the SEC announced that it had adopted amendments updating its rules of practice governing its administrative proceedings. Among other changes, the updated rules provide for additional opportunities for conducting depositions and add flexibility to the timeline for certain administrative proceedings.[117]

Recent developments have limited the SEC's use of administrative proceedings in litigated matters. In 2018, the Supreme Court ruled that administrative law judges of the SEC are "officers of the United States" subject to the Constitution's Appointment Clause.[118] On May 18, 2022, the Fifth Circuit held that the SEC violated the Seventh Amendment's right to a jury trial by bringing defendants before administrative law judges and that Congress unconstitutionally delegated power to the SEC to act as a legislative body.[119] Importantly, on May 16, 2022, the Supreme Court agreed to hear the SEC's bid to block a similar challenge to the constitutionality of these in-house tribunals.[120] As a result, for now, the SEC has essentially restricted the use of administrative proceedings to settled matters and follow-on proceedings for certain relief (e.g., Rule 102(e) proceedings).

Parallel Criminal Investigations

The SEC does not have the authority to bring criminal actions. However, the SEC can refer a matter to the DOJ for criminal prosecution, and parallel civil and criminal investigations are common — particularly if they implicate the anti-fraud statutes or the FCPA. Additionally, information that a company produced to the SEC can (and will) be shared with the DOJ. Therefore, a company should be mindful of that fact and consider the possibility of a criminal investigation when weighing the myriad strategic decisions it must make during an SEC investigation.

Monetary Sanctions

Over the past 15 years, the SEC has increasingly sought significant monetary sanctions. In 2013, for example, then-Chair Mary Jo White stated that the SEC "must make aggressive use of our existing penalty authority, recognizing that meaningful monetary penalties — whether against companies or individuals — play a very important role in a strong enforcement program."[121] More recently, Director Grewal warned of the likelihood of increased monetary penalties.[122] Moreover, the Enforcement Division has noted that it will not rely heavily on precedent in determining monetary sanctions, and will instead evaluate each new investigation on its own merit.[123] In FY 2022, for example, the SEC ordered over $6.4 billion in monetary sanctions, including penalties and disgorgement, the most on record in SEC history.[124]

Although monetary sanctions are often discussed in terms of aggregate amounts, they are composed of three distinct segments: civil penalties, disgorgement, and prejudgment interest. The component parts proposed by the Staff will affect counsel's ability to negotiate the aggregate sanction.

Civil Penalties

The SEC has the authority and discretion to tailor remedies to the seriousness of the violations. A three-tier structure of increasing gravity governs the size of civil monetary penalties that a court may impose for non-insider trading violations. The tier structure penalties are as follows:

- First Tier penalties are assigned to any violations
- Second Tier penalties are reserved for violations involving "fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement"
- Third Tier penalties are reserved for violations involving "fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement" that "directly or indirectly resulted in substantial losses or created a significant risk of substantial losses to other persons or resulted in substantial pecuniary gain" to the violator.[125]

Generally, the securities laws set forth two alternative methods for calculating the maximum penalty. The first method, which is applicable in both administrative and civil actions, permits a "per violation" calculation, the amount of which increases by tier based on the seriousness of the violation. The second method, which is applicable only in civil actions, allows for the imposition of a penalty equal to the "gross amount of pecuniary gain" to the defendant as a result of the violation(s). The chart below outlines the maximum penalties under each tier in each type of action, as of January 2022.[126]

Maximum Penalties Under the Securities Act of 1933 / Securities Exchange Act of 1934[68] (All values in US$)

		Administrative Action	Civil Action
First Tier	*Person*	$9,484 per violation	Greater of (i) $10,360 per violation or (ii) gross amount of pecuniary gain to person
	Entity	$94,847 per violation	Greater of (i) $103,591 per violation or (ii) gross amount of pecuniary gain to entity
Second Tier	*Person*	$94,847 per violation	Greater of (i) $103,591 per violation or (ii) gross amount of pecuniary gain to person
	Entity	$474,233 per violation	Greater of (i) $517,955 per violation or (ii) gross amount of pecuniary gain to entity
Third Tier	*Person*	$189,693 per violation	Greater of (i) $207,183 per violation or (ii) gross amount of pecuniary gain to person
	Entity	$916,850 per violation	Greater of (i) $1,035,909 per violation or (ii) gross amount of pecuniary gain to entity

Companies should recognize that, notwithstanding the statute, the SEC does not take a formulaic approach to determining an appropriate penalty, particularly in settlement negotiations. Rather, when the SEC negotiates a penalty, the agency is often responding to public clamor and pressure to impose high penalties for violations of the federal securities laws. In any event, the SEC can use the statute to justify high penalties. And the SEC can usually find as many violations as it needs to — for example, the SEC can charge each allegedly misstated entry in the books and records of a company as a separate violation. If there is a sufficiently large pecuniary gain, the per violation amounts become irrelevant in civil actions. In cases involving parallel criminal resolutions that result in a criminal fine for the same conduct, the SEC will usually, but not always, forego any civil monetary penalty.

Disgorgement and Prejudgment Interest

The Commission routinely seeks disgorgement of ill-gotten gains plus prejudgment interest from the date of the violation. The SEC historically took the position that disgorgement was an equitable remedy not subject to the five-year statute of limitations. However, in 2017, the Supreme Court held that a disgorgement order in an SEC enforcement action constituted a "penalty" subject to the five-year limitations period applicable to other civil penalties.[127] In 2020, the Court held that the SEC may seek disgorgement as a form of "equitable relief" so long as the remedy remains within "the bounds of traditional equity practice.[128] Although this temporarily limited the SEC, Congress stepped in. As part of the January 1, 2021, passage of the National Defense Authorization Act (NDAA), which overrode a presidential veto, Congress expressly granted the SEC the authority to seek disgorgement for violations of federal securities laws and doubled the statute of limitations for disgorgement awards and other equitable remedies in certain fraud-based cases from five years to 10 years.[129]

Specifically, Section 6501 of the NDAA amends Section 21(d) of the Exchange Act so that it expressly authorizes the SEC, in actions filed in federal district court, to seek "disgorgement … of any unjust enrichment by the person who received such unjust enrichment as a result of [a] violation" of the securities laws.[130] Unlike the Exchange Act provision analyzed by the Supreme Court,[131] the new provision does not expressly require that the relief be "for the benefit of investors."[132]

Section 6501 also prescribes extended limitations periods for disgorgement and other equitable relief. The default limitations period for disgorgement is still five years, but for any violation that requires the SEC to "establish[]" "scienter" — including violations of Section 10(b) of the Exchange Act,[133] Section 17(a)(1) of the Securities Act of 1933,[134] and Section 206(1) of the Investment Advisers Act of 1940[135] — Congress increased the limitations period for disgorgement to 10 years from the latest date of misconduct.[136] The extended 10-year limitations period also applies in both scienter and non-scienter actions with respect to other "equitable remedies," including injunctions and other sanctions such as industry bars and suspensions.[137]

The case law on disgorgement generally states that disgorgement need only be a reasonable approximation of a defendant's ill-gotten gains, and that once the SEC makes a prima facie showing that the proposed amount is such an approximation, a defendant bears the burden of demonstrating that the amount is not appropriate.[138] In cases involving false financial statements or false SEC filings, courts have ordered defendants to disgorge any profits resulting from the inadequacy of disclosures made.[139] Such a measure is necessarily complicated, and rebutting the SEC's assertion may require the engagement of forensic experts.[140]

Courts may award prejudgment interest on disgorgement on a discretionary basis. The time frame for imposing prejudgment interest usually begins with the date of the unlawful gain and ends at the entry of judgment.[141] Prejudgment interest may significantly increase the amount the SEC recovers, particularly because there may be years between the time that the conduct occurred that gave rise to the alleged violation of the securities laws and the time a court enters a judgment.

Potential Admissions Required for a Settlement

Historically, in SEC settlements, parties would neither admit nor deny the Commission's allegations, findings, or conclusions.[142] In recent years, however, the SEC has consistently amended its longstanding policy permitting a company to settle without admitting or denying the allegations in the complaint.

In early 2012, the SEC announced that it would eliminate the "neither admit nor deny" language in cases where there had already been admissions or adjudications of fact in criminal cases.[143] Thus, in cases involving a parallel criminal conviction, or a non-prosecution or deferred-prosecution agreement including admissions or acknowledgement of criminal conduct, the SEC did not include the standard "neither admit nor deny" language and recited the fact and nature of the criminal conviction or non-prosecution or deferred-prosecution agreement in the settlement documents. This policy change initially did not require admissions beyond those already included in the criminal proceedings.

In June 2013, then-Chair White announced that the SEC would expand the scope of settlements where admissions may be appropriate. She also announced a policy requiring admissions in cases of egregious conduct or widespread investor harm.[144] An internal memo from the co-heads of the Enforcement Division cited three criteria for determining whether admissions may be necessary:

- "Misconduct that harmed large numbers of investors or placed investors or the market at risk of potentially serious harm"
- "Egregious intentional misconduct"
- "When the defendant engaged in unlawful obstruction of the commission's investigative processes"[145]

The memo acknowledged that "most" cases would continue to be settled without requiring admissions, but advised that in certain cases "heightened accountability or acceptance of responsibility through the defendant's admission of misconduct may be appropriate, even if it does not allow us to achieve a prompt resolution."[146]

Under the Trump Administration, although the SEC did not affirmatively announce a policy change, the Enforcement Division largely reverted back to the historical approach, resulting in a decrease of admissions of guilt in SEC enforcement actions.[147]

Under the Biden Administration, Director Grewal announced that the SEC will again require admissions in certain matters. In October 2021 remarks, Director Grewal noted, "When it comes to accountability, few things rival the magnitude of wrongdoers admitting that they broke the law, and so, in an era of diminished trust, we will, in appropriate circumstances, be requiring admissions in cases where heightened accountability and acceptance of responsibility are in the public interest."[148] Director Grewal went on, "Admissions, given their attention-getting nature, also serve as a clarion call to other market participants to stamp out and self-report the misconduct to the extent it is occurring in their firm."[149]

Collateral Consequences of an SEC Settlement

SEC resolutions can trigger a variety of collateral consequences. Each case is unique, and the nature and extent of any collateral consequences will depend on the particular facts and resolution. Some of the potential collateral consequences that public companies may face are set forth below.

Impact on Other Litigation

> SEC resolutions can trigger a variety of collateral consequences. Each case is unique and the nature and extent of any collateral consequences will depend on the particular facts and resolution.

As noted above, historically, public companies settling with the SEC were able to resolve matters without admitting or denying the Commission's allegations, findings, or conclusions. In addition, in a settled enforcement action, there is no adjudication on the merits of the Commission's allegations. Accordingly, SEC settlements without an admission have no preclusive effect — meaning the fact of a settlement does not preclude litigating the underlying facts in another proceeding like a securities class action.[150] Some recent cases, however, have explored whether any part of the settlement is admissible in subsequent litigation.[151] To the extent a company is required to make an admission to settle with the SEC, however, that admission would be admissible and could have preclusive effect in other litigation. This means that the company would be unable to argue a contrary position, thereby impacting the ability to prevail and the settlement value of any other litigation.

Public Company Disclosure Obligations

The disclosures a settlement requires will turn in part on the violations charged. The resolution itself is public, but the entry of an injunction or administrative order against a public company may trigger other disclosure obligations within the company's SEC filings, particularly under Regulation S-K. In any event, a company should carefully consider the appropriate and accurate public disclosure of the settlement.

Ineligibility to File Automatic Shelf Registration Statements

A company that is a Well-Known Seasoned Issuer (WKSI) has the ability to file shelf registration statements that are automatically and immediately effective without Staff review.[152] Under Rule 405 of the Securities Act, a WKSI cannot be an "ineligible issuer." An ineligible issuer includes an issuer who has (or whose subsidiaries have) within the three years prior to the applicable determination date been the subject of a judicial or administrative decree or order (including a settled claim or order) involving allegations or violations of, or prohibiting future violations of, the anti-fraud provisions of the federal securities laws.[153]

An issuer can apply for an exemption from ineligible issuer status by obtaining a waiver "upon a showing of good cause, that it is not necessary under the circumstances that the issuer be considered an ineligible issuer."[154] As with Regulation D waivers, the Commission has delegated authority to grant such waivers to the Division of

Corporation Finance.[155] In deciding whether to grant a waiver, which may include conditions or undertakings, the Division of Corporation Finance considers, among other factors, who at the issuer was responsible for the misconduct, the remediation the issuer implemented, and the impact of denying a waiver.[156] The burden of showing good cause is much increased as of late, particularly if the underlying conduct includes a scienter violation.[157]

Disqualification From Certain Offerings

Rule 506 of Regulation D permits a company to raise an unlimited amount of capital if the company sells the securities only to accredited investors and 35 additional purchasers who qualify as sophisticated investors.[158] Dodd-Frank required the Commission to adopt disqualification regulations applicable to offerings and sales of securities under Rule 506.[159] Under the rule, an issuer cannot rely on Rule 506 if certain individuals or entities (including directors and officers who participate in the offering) have been subject to a disqualifying event such as SEC enforcement orders or court judgments involving the scienter-based anti-fraud provisions of the federal securities laws.

A company may apply to obtain an exemption from this disqualification. Regulation D allows issuers to be exempted from the disqualification if the regulatory order giving rise to the disqualification states in writing that the disqualification "should not arise."[160] In other words, a company can attempt to seek a statement from the Commission that the disqualification need never take effect. In addition, issuers may seek a waiver "upon a showing of good cause . . . that it is not necessary under the circumstances that the exemption be denied."[161] A company must make the request by applying to the Division of Corporation Finance.[162] Granting these waivers has been a point of contention both within the SEC and among legislators, and the Commission can make the waivers conditional.[163]

Loss of Safe Harbor for Forward-Looking Statements

Section 27A of the Securities Act and Section 21E of the Exchange Act provide issuers with safe harbors from private actions alleging that certain forward-looking statements were materially untrue or incomplete.[164] An issuer who — in the three years prior to the forward-looking statement — was "the subject of a judicial or administrative decree or order arising out of a government action that . . . prohibits future violations of the anti-fraud provisions of the securities laws . . . [or] determines that the issuer violated the anti-fraud provisions of the securities laws" cannot take advantage of the safe harbor provisions.[165] However, a disqualified issuer may apply to the Commission for exemption.[166]

Conclusion

SEC investigations can be complex, costly, and time-consuming. But understanding the process and pitfalls can help public company executives and in-house counsel navigate the process, while avoiding unnecessary distraction from business operations. Understanding the process, risks, and strategic issues a company will face can help avoid missteps and move the investigation toward resolution as quickly as possible with the least disruption to the company, its executives, and its employees.

Endnotes

[1] SEC Press Release, SEC Announces Enforcement Initiatives to Combat Financial Reporting and Microcap Fraud and Enhance Risk Analysis (July 2, 2013), http://www.sec.gov/News/PressRelease/Detail/PressRelease/1365171624975.

[2] Andrew Ceresney, Director, Division of Enforcement, US Securities & Exchange Commission, Directors Forum 2016 Keynote Address. https://www.sec.gov/news/speech/directors-forum-keynote-ceresney.html.

[3] All values are in US dollars.

[4] The SEC maintains extensive information about itswhistleblower program at https://www.sec.gov/whistleblower.

[5] SEC Whistleblower Office Announces Results for FY 2022 (Nov. 15, 2022), https://www.sec.gov/files/2022_ow_ar.pdf.

[6] *Id*.

[7] SEC, 2021 Annual Report to Congress on Dodd-Frank Whistleblower Program (2021), https://www.sec.gov/files/owb-2021-annual-report.pdf; SEC Whistleblower Office Announces Results for FY 2022 (Nov. 15, 2022), https://www.sec.gov/files/2022_ow_ar.pdf.

[8] SEC Whistleblower Office Announces Results for FY 2022 (Nov. 15, 2022), https://www.sec.gov/files/2022_ow_ar.pdf.

[9] *Id*.

[10] SEC Press Release, *SEC Amends Whistleblower Rules to Incentivize Whistleblower Tips* (Aug. 22, 2022), https://www.sec.gov/news/press-release/2022-151.

[11] *Id*.; 17 C.F.R. § 240.21F-3.

[12] *In the Matter of Guggenheim Sec., LLC*, File No. 3-20370 (June 23, 2021).

[13] *U.S. Sec. & Exch. Comm'n v. GPB Capital Holdings, LLC, et al*., No. 21-cv-00583 (E.D.N.Y.) (Feb. 4, 2021).

[14] SEC, 2021 Annual Report to Congress on Dodd-Frank Whistleblower Program (2021), https://www.sec.gov/files/owb-2021-annual-report.pdf; SEC Whistleblower Office Announces Results for FY 2022 (Nov. 15, 2022), https://www.sec.gov/files/2022_ow_ar.pdf.

[15] *See generally* SEC Press Release, *SEC Announces Enforcement Results for FY22* (Nov. 15, 2022), https://www.sec.gov/news/press-release/2022-206 ("Environmental, social, and governance (ESG) concerns have grown increasingly important to many investors. As a result, the Division has focused attention on these issues with respect to public companies and investment products and strategies.").

[16] SEC Press Release, *SEC Announces Enforcement Task Force Focused on Climate and ESG Issues* (March 4, 2021), https://www.sec.gov/news/press-release/2021-42.

[17] *See, e.g.,* SEC Press Release, *Mylan to Pay $30 Million for Disclosure and Accounting Failure Relating to EpiPen* (Sept. 27, 2019), https://www.sec.gov/news/press-release/2019-194; *See, e.g.,* SEC Press Release, *SEC Obtains Final Judgment Against Rpm International Inc. and Its General Counsel* (Dec. 23, 2020), https://www.sec.gov/litigation/litreleases/2020/lr24994.htm.

[18] *See* SEC Press Release, *SEC Announces Enforcement Results for FY 2021* (Nov. 18, 2021), https://www.sec.gov/news/press-release/2021-238 (describing "Rooting Out Misconduct in Crypto" as an example of "enforcement actions in key prior areas"); *see also* SEC Press Release, *SEC Charges Three Individuals in Digital Asset Frauds* (Feb. 1, 2021), https://www.sec.gov/news/press-release/2021-22; SEC Litigation Release, *Securities and Exchange Commission v. Uulala, Inc., Oscar Garcia, and Matthew Loughran*, No. 5:21-cv-01307 (C.D. Cal. filed August 4, 2021), https://www.sec.gov/litigation/litreleases/2021/lr25157.htm; SEC Press Release, *BlockFi Agrees to Pay $100 Million in Penalties and Pursue Registration of its Crypto Lending Product* (Feb. 14, 2022), https://www.sec.gov/news/press-release/2022-26.

[19] *See* SEC Press Release, *SEC Nearly Doubles Size of Enforcement's Crypto Assets and Cyber Unit* (May 3, 2022), https://www.sec.gov/news/press-release/2022-78.

[20] *See generally* SEC Press Release, *SEC Announces Enforcement Results for FY22* (Nov. 15, 2022), https://www.sec.gov/news/press-release/2022-206 (identifying "cybersecurity and compliance" as a focus of the Commission in FY 2022).

[21] *See e.g.,* SEC Press Release, *SEC Announces Three Actions Charging Deficient Cybersecurity Procedures* (Aug 30, 2021), https://www.sec.gov/news/press-release/2021-169.

[22] *See e.g.,* SEC Press Release, *SEC Charges Issuer With Cybersecurity Disclosure Controls Failures* (June 15, 2021), https://www.sec.gov/news/press-release/2021-102.

[23] *See e.g.,* SEC Press Release, *SEC Charges Pearson plc for Misleading Investors About Cyber Breach* (Aug. 16, 2021), https://www.sec.gov/news/press-release/2021-154.

[24] *See generally* SEC Press Release, *SEC Announces Enforcement Results for FY22* (Nov. 15, 2022), https://www.sec.gov/news/press-release/2022-206 (describing "market abuses" as a key priority area of the Commission).

[25] *See, e.g.,* SEC Press Release, *SEC Charges S&P Dow Jones Indices for Failures Relating to Volatility-Related Index* (May 17, 2021), https://www.sec.gov/news/press-release/2021-84.

[26] *See, e.g.,* SEC Press Release, *SEC Charges Ratings Agency With Disclosure And Internal Controls Failures Relating To Undisclosed Model Adjustments* (Feb 17, 2021), https://www.sec.gov/news/press-release/2021-29.

[27] *See, e.g.,* SEC Press Release, *SEC Charges Orchestrator of Cryptocurrency Scheme Ensnaring Physicians* (Feb 11, 2020), https://www.sec.gov/news/press-release/2020-32.

[28] *See, e.g.,* SEC Press Release, *SEC Charges SPAC, Sponsor, Merger Target, and CEOs for Misleading Disclosures Ahead of Proposed Business Combination* (July 13, 2021), https://www.sec.gov/news/press-release/2021-124.

[29] *See, e.g.*, T. Zanki, *SEC's Gensler Targets Private Equity And Hedge Fund Fees*, https://www.law360.com/articles/1456861/sec-s-gensler-targets-private-equity-and-hedge-fund-fees (describing Gensler's January 19, 2022 speech to Exchequer Club of Washington, D.C., that the SEC would bolster transparency around private equity and hedge fund fees and focus on the costs to investors; L. Berg, *SEC Chair Wants Transparency In Private Fund Investor Fees*, https://www.law360.com/articles/1439778/sec-chair-wants-transparency-in-private-fund-investor-fees (describing November 2021 speech in which Gensler discussed increased scrutiny of fees charged by private investors).

[30] In FY 2022, for example, the SEC obtained $1.235 billion in cumulative penalties paid in connection with recordkeeping violations. *See* SEC Press Release, *SEC Announces Enforcement Results for FY22* (Nov. 15, 2022), https://www.sec.gov/news/press-release/2022-206. *See also* Chairman Gary Gensler, Remarks Before the Practicing Law Institute's 54th Annual Institute on Securities Regulation, *This Law and Its Effective Administration*, (Nov. 2, 2022), https://www.sec.gov/news/speech/gensler-remarks-practising-law-institute-110222?utm_medium=email&utm_source=govdelivery#_ftnref6 ("I hope this sends a message to other registrants. Books and records matter. We will strive to ensure that penalties are not seen as the cost of doing business. We will use sweeps, initiatives, and undertakings to shape market behavior."); *see also In re J.P. Morgan Securities LLC*, Release No. 34-93807 (Dec. 17, 2021), available at https://www.sec.gov/news/press-release/2021-262 (imposing $125 million penalty on J.P. Morgan Securities for widespread failures to meet recordkeeping obligations).

[31] *See e.g.,* Chairman Gary Gensler, Remarks Before the Practicing Law Institute's 54th Annual Institute on Securities Regulation, *This Law and Its Effective Administration*, (Nov. 2, 2022), https://www.sec.gov/news/speech/gensler-remarks-practising-law-institute-110222?utm_medium=email&utm_source=govdelivery#_ftnref6 ("When lawyers—or other gatekeepers, like auditors and underwriters—breach their positions of trust and violate the securities laws, we will not hesitate to take action."); SEC Press Release, *SEC Charges Disbarred New York Attorney and Florida Attorney with Scheme to Create False Opinion Letters* (Dec. 2, 2020), https://www.sec.gov/news/press-release/2020-300; SEC Litigation Release, *SEC Obtains Final Judgment Against Securities Lawyer and Microcap Agent and Bars Lawyer from Practicing or Appearing Before the SEC* (Aug. 19, 2021), https://www.sec.gov/litigation/litreleases/2021/lr25175.htm; *see also In re John W. Pauciulo, Esq*., Release No. 33-11080 (July 7, 2022), available at https://www.sec.gov/enforce/33-11080-s (attorney charged for his role in an unregistered, fraudulent securities offering, and Commission suspended him from practicing before the SEC as an attorney).

[32] *See e.g., In re Ernst & Young LLP*, Release No. 34-95167 (June 28, 2022), available at https://www.sec.gov/news/press-release/2022-114 (charging Ernst & Young for cheating by its audit professionals on its ethics exams); *In re Deloitte Touche Tohmatsu Certified Public Accountants LLP*, Release No. 34-95938 (Sept. 29, 2022), available at https://www.sec.gov/news/press-release/2022-176 (charging Deloitte-China for abdicating their responsibility as a gatekeeper and imposing a $20 million penalty); SEC Press Release, *Charges Two Former KPMG Auditors for Improper Professional Conduct During Audit of Not-for-Profit College* (Feb 23, 2021), https://www.sec.gov/news/press-release/2021-32; SEC Press Release, *Auditor Charged for Failure to Register with PCAOB and Multiple Audit Failures* (Aug. 5, 2021), https://www.sec.gov/news/press-release/2021-56; Gurbir Grewal, Director, Division of Enforcement, Remarks at SEC Speaks 2021 (Oct. 13, 2021), https://www.sec.gov/news/speech/grewal-sec-speaks-101321 ("And it's those additional areas of focus that I want to turn to next. They include emphasizing corporate responsibility, gatekeeper accountability and appropriate remedies, particularly prophylactic ones.").

[33] *See generally,* SEC Press Release, *SEC Announces Enforcement Results for FY 2022* (Nov. 15, 2022), https://www.sec.gov/news/press-release/2022-206 (describing gatekeeper actions as "focus" or Enforcement Division).

[34] *See generally* SEC Press Release, *SEC Announces Enforcement Results for FY22* (Nov. 15, 2022), https://www.sec.gov/news/press-release/2022-206 ("Individual accountability is a pillar of the SEC's enforcement program. Similar to prior years, in fiscal year 2022, more than two-thirds of the SEC's stand-alone enforcement actions involved at least one individual defendant or respondent."); SEC Press Release, *SEC Announces Enforcement Results for FY 2021* (Nov. 18, 2021), https://www.sec.gov/news/press-release/2021-238 (describing "holding individuals accountable" as an example among "enforcement actions in key priority areas"); Gurbir Grewal, Director, Division of Enforcement, Remarks at SEC Speaks 2021 (Oct. 13, 2021), https://www.sec.gov/news/speech/grewal-sec-speaks-101321 ("Officer and director bars, likewise, are a critical tool in our efforts. The authority to impose them in cases involving scienter-based violations is broad and there is no legal requirement that the individual be an officer or director of a public company, or indeed a public company employee at all, for a bar to be appropriate."); Chairman Gary Gensler, Remarks Before the Practicing Law Institute's 54th Annual Institute on Securities Regulation, *This Law and Its Effective Administration*, (Nov. 2, 2022), https://www.sec.gov/news/speech/gensler-remarks-practising-law-institute-110222?utm_medium=email&utm_source=govdelivery#_ftnref6 ("Make no mistake: If a company or executive misstates or omits information material to securities investors, whether in an earnings call, on social media, or in a press release, we will pursue them for violating the securities laws.").

[35] *See* SEC Press Release, *SEC Announces Enforcement Results for FY22* (Nov. 15, 2022), https://www.sec.gov/news/press-release/2022-206; J. Choi et. Al, Harvard Law School Forum on Corporate Governance, SEC Enforcement Trends: Five Key Takeaways (Dec. 30, 2021), https://corpgov.law.harvard.edu/2021/12/30/sec-enforcement-trends-five-key-takeaways/.

[36] The *Enforcement Manual* is available at https://www.sec.gov/divisions/enforce/enforcementmanual.pdf.

[37] The *Enforcement Manual* states that MUIs should generally be closed or converted into a formal investigation within 60 days. *SeeEnforcement Manual* § 2.3.1.

[38] Section 21(b) of the Exchange Act (and similar provisions in other federal securities statutes) authorizes the SEC to conduct investigations of possible violations of the federal securities laws. The Commission issues formal orders of investigation that authorize specific enforcement Staff to exercise the Commission's authority to subpoena documents and witnesses. Prior to 2009, a formal order of investigation had to be authorized by the Commission itself. In 2009, the SEC's Rules of Practice were amended to delegate authority to the Director of the Division of Enforcement. *See* Exchange Act Release No. 60448 (Aug. 11, 2009), https://www.sec.gov/rules/ final/2009/34-60448.pdf; Exchange Act Release 62690 (Aug. 16, 2010), https://www.sec.gov/rules/final/2010/34-62690.pdf.

[39] Securities Exchange Act of 1934, Pub. L. 73–291, 48 Stat. 881, 15 U.S.C. § 78a et seq.; SEC Rule 10b-5, 17 C.F.R. § 240.10b-5.

[40] Securities Act of 1933, 48 Stat. 74, 15 U.S.C. § 77q(a) et seq.

[41] There are other antifraud provisions in the federal securities laws. *See, e.g.*, 15 U.S.C. § 78o(c) (fraud by registered broker dealers);15 U.S.C. § 80b-6 (Investment Advisers Act prohibited transactions). However, they are less relevant to public companies and public company financial statements. Additionally, 15 U.S.C. § 77k(a) (Section 11 of the 1933 Securities Act) and 15 U.S.C. § 77l(a) (Section 12(a)(2) of the 1933 Securities Act) provide exclusively private causes of action related to false or misleading disclosures by public companies.

[42] *Aaron v. SEC*, 446 U.S. 680, 691, 695, 697 (1980).

[43] *See, e.g., SEC v. Platforms Wireless Int'l Corp.,* 617 F.3d 1072, 1092 (9th Cir. 2010); *SEC v. Fife*, 311 F.3d 1, 9–10 (1st Cir. 2002); *SEC v. Infinity Grp. Co.*, 212 F.3d 180, 192 (3d Cir. 2000); *Sundstrand Corp. v. Sun Chem. Corp.*, 553 F.2d 1033, 1044 (7th Cir. 1977). Although the Supreme Court has "previously reserved the question whether reckless behavior is sufficient for civil liability under § 10(b) and Rule10b-5," it has noted that "[e]very Court of Appeals that has considered the issue has held that a plaintiff may meet the scienter requirement by showing that the defendant acted intentionally or recklessly, though the Circuits differ on the degree of recklessness required." *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 319 n.3 (2007).

[44] *Aaron*, 446 U.S. at 697.

[45] 15 U.S.C. § 77q(a).

[46] 15 U.S.C. § 78t(a).

[47] 15 U.S.C. § 78t(e).

[48] 15 U.S.C § 78u–3(a). An action for "causing' liability must be brought as a cease-and-desist proceeding, *see id*.

[49] *Maher v. Durango Metals, Inc.*, 144 F.3d 1302, 1305 (10th Cir. 1998) ("[O]nce the plaintiff establishes the prima facie case, the burden shifts to the defendant to show lack of culpable participation or knowledge."). The defendant can also rebut plaintiff's

prima facie case by submitting an affirmative defense of good faith. 15 U.S. Code § 78t(a) ("…unless the controlling person acted in good faith and did not directly or indirectly induce the act or acts constituting the violation or cause of action.").

50 15 U.S.C. § 78t(e); *Sec. & Exch. Comm'n v. Life Partners Holdings, Inc*., 854 F.3d 765, 778 (5th Cir. 2017); *SEC v. Shanahan*, 646 F.3d 536, 547 (8th Cir. 2011); *Graham v. SEC*, 222 F.3d 994, 1000 (D.C. Cir. 2000); *SEC v. Mattessich*, 407 F.Supp.3d 264, 269 (S.D.N.Y, Sept. 9, 2019).

51 *See Howard v. SEC*, 376 F.3d 1136, 1141 (D.C. Cir. 2004) (holding that if "scienter [is] an element of the primary violation[]," then causing liability requires scienter as well, but that if, by contrast, the "primary violation . . . does not require scienter," then "negligence is sufficient to establish 'causing' liability" (internal quotations omitted)).

52 15 U.S.C. §78dd-1 § 30A.

53 *Id*.

54 SEC enforcement actions have involved a number of foreign issuers. *See, e.g.*, Complaint, *SEC v. Magyar Telekom Plc., et al.*, No. 11-cv-9646 (S.D.N.Y. Dec. 29, 2011), ECF No. 1 (German and Hungarian companies), *available at* http://www.sec.gov/litigation/complaints/2011/comp22213-co.pdf.

55 *See, e.g.*, Criminal Information, *United States v. Telefonaktiebolaget LM Ericsson*, No. 19-cr-884 (S.D.N.Y. Dec. 6, 2019), ECF No. 3 (charging issuer company with violating FCPA for paying bribes to foreign officials in Djibouti,China, Vietnam, Indonesia, and Kuwait), available at https://justice.gov/criminal-fraud/file/1226526/download; Criminal Information, *United States v. Tim Leissner*, No. 18-cr-439 (E.D.N.Y. Aug. 28, 2018), ECF No. 16 (charging an employee and agent of U.S. publicly traded company with violating FCPA for bribery of official in Malaysia), available at https://www.justice.gov/criminal-fraud/file/1231346/download.

56 15 U.S.C. §78dd-1 § 30A.

57 *Id*.

58 15 U.S.C. § 78m(a); 17 C.F.R. §§ 240.13a-1, 240.13a-13.

59 *See, e.g., McConville v. SEC*, 465 F.3d 780, 787–88 (7th Cir. 2006); *Ponce v. SEC*, 345 F.3d 722, 735–36 (9th Cir. 2003).

60 15 U.S.C. § 78m(a); 17 CFR § 240.13a-11.

61 15 U.S.C. § 78m(a); 17 CFR § 240.12b-20.

62 *SEC v. McNulty*, 137 F.3d 732, 740–41 (2d Cir. 1998); *SEC v. Wills*, 472 F. Supp. 1250, 1268 (D.D.C. 1978).

63 *See, e.g., Ponce*, 354 F.3d at 734–37; *SEC v. Koenig*, 469 F.2d 198, 200 (2d Cir. 1972).

64 15 U.S.C. § 78m(b)(2)(A).

65 15 U.S.C. § 78m(b)(7).

66 15 U.S.C. § 78m(b)(2)(B).

67 17 C.F.R. § 240.13a-15.

68 15 U.S.C. § 78m(b)(5), 17 C.F.R. § 240.13b2-1.

69 17 C.F.R. § 240.13a-14.

70 17 C.F.R. § 240.13b2-2.

71 For instance, if the recipient of an SEC subpoena refuses to comply, the Staff is required to file an action in federal district court to enforce compliance, and that action would be a matter of public record. *See* Section 21(c) of the Exchange Act. 15 U.S.C. § 78u(c).

72 In 2016, a federal district court in the Southern District of New York dismissed a shareholder suit alleging that defendants had violated securities laws by failing to disclose receipt of a Wells notice. *In re Lions Gate Entm't Corp. Sec. Litig.*, 165 F. Supp. 3d 1 (S.D.N.Y. 2016). Among other conclusions, the court held that that receipt of a Wells notice, without additional factors, does not trigger a duty to disclose under Section 10(b) of the Exchange Act and Rule 10b-5 because the Commission may ultimately choose not to initiate an action against the investigation target and so the Wells notice itself is not an indication that material litigation is substantially likely to occur. *Id.* at 12–13.The court found further that the fact of the investigation was not *per se* material and that the plaintiffs had failed to allege how knowledge of a preliminary SEC investigation for which there was no settlement in place at the time of the Class Period would have significantly altered the total mix of information available to an investor. *Id.* at 14.

[73] 17 C.F.R. § 229.103.

[74] 17 C.F.R. § 229.303.

[75] 17 C.F.R. § 229.401(f).

[76] 17 C.F.R. § 229.503(c).

[77] *See* Accounting Standards Codification Topic 450, *Contingencies* (ASC 450) (originally Statement of Financial Accounting Standards No.5, *Accounting for Contingencies* (FAS No. 5)).

[78] *See* 18 U.S.C. § 1350; 17 C.F.R. §§ 240.13a-14, 15d-14.

[79] Regulation FD sets forth the SEC rules governing selective disclosure by companies of material nonpublic information. The SEC adopted Regulation FD to prevent material nonpublic information from being given selectively to market professionals such as broker-dealers, investment advisers and managers, and investment companies, who could use such information to their own or their clients' advantage. Regulation FD applies to communications on behalf of the issuer with market professionals and with security holders who may foreseeably trade on the basis of the disclosed information. *See* 17 C.F.R. pt. 243.

[80] *See* 18 U.S.C. § 1519, *Destruction, alteration, or falsification of records in Federal investigations and bankruptcy*; 18 U.S.C. § 1520, *Destruction of corporate audit records*.

[81] *See Enforcement Manual* § 3.2.3.

[82] Courts have upheld the SEC's authority, as well as the authority of other agencies operating under similar statutes, to seek documents located abroad through administrative subpoenas that are served in the United States. *See, e.g., Civil Aero. Bd. v. Deutsche Lufthansa Aktiengesellschaft*, 591 F.2d 951, 952–53 (D.C. Cir. 1979); *SEC v. Minas de Artemisa, S.A.*, 150 F.2d 215, 218 (9th Cir. 1945).

[83] *Enforcement Manual* § 4.3.1.

[84] *See Upjohn Co. v. United States*, 449 U.S. 383 (1981). An *Upjohn* instruction should make clear to the witness that counsel represents the company and not the employee individually; conversations with the employee may be protected by the attorney-client privilege if counsel seeks information to provide legal advice to the company; the privilege, however, belongs to the company exclusively; and the company may decide to waive the privilege and disclose the communications with the employee to third parties, including the government.

[85] *See, e.g.*, Robert S. Khuzami, Director, Division of Enforcement, Remarks to Criminal Law Group of the UJA-Federation of New York, (June 1, 2011), https://www.sec.gov/news/speech/2011/spch060111rk.htm.

[86] Enforcement Manual § 4.1.3.

[87] *Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934 and Commission Statement on the Relationshipof Cooperation to Agency Enforcement Decisions*, Exchange Act Release No. 44969, (Oct. 23, 2001) http://www.sec.gov/litigation/ investreport/34-44969.htm (hereinafter *Seaboard Report*).

[88] https://www.sec.gov/spotlight/enforcement-cooperation-initiative.shtml. *See also* Chairman Gary Gensler, Remarks Before the Practicing Law Institute's 54th Annual Institute on Securities Regulation, *This Law and Its Effective Administration*, (Nov. 2, 2022), https://www.sec.gov/news/speech/gensler-remarks-practising-law-institute-110222?utm_medium=email&utm_source=govdelivery#_ftnref6 ("If you mess up—and people do mess up sometimes—come in and talk to us, cooperate with our investigation, and remediate your misconduct.").

[89] *Seaboard Report*.

[90] *Id*.

[91] The Commission's statement announcing the initiative identified four general considerations to use in assessing cooperation by individuals: (i) the assistance provided by the cooperator; (ii) the importance of the underlying matter; (iii) societal interest in holding the individual accountable for his or her misconduct; and (iv) the appropriateness of cooperation based on the risk profile of the individual. *See* SEC Press Release, *SEC Announces Initiative to Encourage Individuals and Companies to Cooperate and Assist in Investigations* (Jan. 13, 2010), https://www.sec.gov/news/press/2010/2010-6.htm; *see also* Robert S. Khuzami, Director, Division of Enforcement, Remarks Before the New York City Bar: My First 100 Days as Director of Enforcement (Aug. 5, 2009), https://www.sec.gov/news/speech/2009/ spch080509rk.htm.

[92] *Enforcement Manual* § 6.2.

[93] Gurbir Grewal, Director, SEC Enforcement Division, Conversation with D.C. Bar (Dec. 15, 2021); New Enforcement Director Outlines Priorities for "Robust" Enforcement at SEC (Dec. 17, 2021), https://www.jdsupra.com/legalnews/new-enforcement-director-outlines-7837366/.

[94] *See, e.g., S*EC Speech, *Remarks at Securities Enforcement Forum West 2022* (May 12, 2022), https://www.sec.gov/news/speech/grewal-remarks-securities-enforcement-forum-west-051222 ("To me, cooperation is more than the absence of obstruction; it's an affirmative behavior…There's no exhaustive checklist of what constitutes cooperation, though as described in the Seaboard report, behaviors such as self-reporting and remediation fall within the cooperation rubric. But here are some more examples of good cooperation: when your clients are involved in an investigation, you can make documents or witnesses available to us on an expedited basis, highlighting "hot" documents or providing translations of key documents where applicable. You can flag documents that you know we're interested in, even if they might arguably, under a certain reading, fall outside the scope of a subpoena. You can make presentations to the Staff during an investigation that are not simply advocacy pieces, but that meaningfully illuminate events. And, where your client may have violated the law, you can counsel them to own that violation and work in good faith to remedy it. In short, you can take steps that enable us to efficiently conduct our investigations, protect investors, and rebuild trust in our markets and the law."); SEC Press Release, *Remediation Helps Tech company Avoid Penalties* (Jan. 28, 2022), https://www.sec.gov/news/press-release/2022-14 (following a January 2022 settlement with HeadSpin, Inc., Director Grewal noted that the settlement was "an excellent example" "[f]or companies wondering what types of remedial actions and cooperation might be credited by the Commission after a company uncovers fraud." There, the company's cooperation and remediation consisted of its Board of Directors conducting an internal investigation, leading to the CEO's removal, a revised valuation, repaying of investors, hiring new senior management, expanding the company's board, and implementing new processes and procedures, "all of which were factors that counseled against the imposition of a penalty in this case[.]").

[95] *Enforcement Manual* § 2.4. The other two factors for the Staff to consider are "whether access to portions of the file would be a productive way for both the Staff and the recipient of the Wells notice to assess the strength of the evidence that forms the basis for the Staff's recommendations" and "the stage of the investigation with regard to other persons or witnesses, including whether certain witnesses have yet to provide testimony."

[96] *Enforcement Manual* § 4.3.

[97] *Westinghouse Elec. Corp. v. Republic of Phil.*, 951 F.2d. 1414, 1427 (3d Cir. 1991).

[98] Although recognized by the Eighth Circuit, the First, Third, Fourth, Sixth, Ninth, Tenth, D.C., and Federal Circuits have rejected the selective waiver doctrine. *See In re Pac. Pictures Corp.*, 679 F.3d 1121, 1129 (9th Cir. 2012); *In re Qwest Commc'ns Int'l, Inc.*, 450 F.3d 1179, 1197 (10th Cir. 2006); *Burden-Meeks v. Welch*, 319 F.3d 897, 899 (7th Cir. 2003); *In re Columbia/HCA Healthcare Corp. Billing Practices Litig.*, 293 F.3d 289, 295 (6th Cir. 2002); *United States v. Mass. Inst. of Tech.*, 129 F.3d 681, 686 (1st Cir. 1997); *Genentech, Inc. v. United States Int'l Trade Comm'n*, 122 F.3d 1409, 1416–18 (Fed. Cir. 1997); *Westinghouse Elec. Corp.*, 951 F.2d at 1425; *In re MartinMarietta Corp.*, 856 F.2d 619, 623–24 (4th Cir. 1988); *Permian Corp. v. United States*, 665 F.2d 1214, 1221 (D.C. Cir. 1981); *Diversified Indus., Inc. v. Meredith*, 572 F.2d 596 (8th Cir. 1978) (en banc). The Second Circuit does not have a *per se* rule rejecting selective waiver, but has recognized it only in limited cases. *See In re Steinhardt Partners, L.P.*, 9 F.3d 230, 235–36 (2d Cir. 1993).

[99] *See, e.g., SEC v. Microtune, Inc.*, 258 F.R.D. 310, 317 (N.D. Tex. 2009) ("When a party waives the attorney-client privilege, it waives the privilege as to all communications that pertain to the same subject matter of the waived communication."); *see also Nguyen v. Excel Corp.*,197 F.3d 200, 208 (5th Cir. 1999) ("[D]isclosure of any significant portion of a confidential communication waives the privilege as to the whole.").

[100] *See, e.g., In re Initial Pub. Offering Sec. Litig.*, 249 F.R.D. 457, 466 (S.D.N.Y. 2008) (finding work-product protection was waived when defendant provided materials to the SEC in response to an SEC inquiry); *SEC v. Brady*, 238 F.R.D. 429, 444 (N.D. Tex. 2006) (finding waiver of work-product protections where defendant disclosed privileged information and documents to the SEC, under a confidentiality agreement, in response to an informal SEC investigation).

[101] Disclosure of materials protected by work-product does not automatically waive work-product protections. Instead, waiver occurs when the documents are either made available to an adversary or to a third party that could serve as a conduit to an adversary. Put differently, waiver results if the work-product is treated in a manner that substantially increases the likelihood that an adversary will come into possession of the material. *See Mass. Inst. of Tech*, 129 F.3d at 687 (stating that "work product protection is provided against 'adversaries,' so only disclosing material in a way inconsistent with keeping it from an adversary waives work product protection").

[102] *See, e.g.*, *SEC v. Herrera*, No. 17-cv-20301, 2017 WL 6041750 at *5 (S.D. Fla. Dec. 5, 2017) (reasoning that the court is "not convinced" that "there is a meaningful distinction between the actual production of a witness interview note or memo and providing the same or similar information orally"); *SEC v. Vitesse Semiconductor Corp.*, No. 10 CIV. 9239 JSR, 2011 WL 2899082, at *3 (S.D.N.Y. July 14, 2011) ("While it is undisputed that NuHo did not actually produce the notes themselves to the SEC, after reviewing the SEC's notes the Court found that NuHo effectively produced these notes to the SEC through its oral

summaries."); *S.E.C. v. Berry*, No. C07-04431 RMW HRL, 2011 WL 825742, at *5–6 (N.D. Cal. Mar. 7, 2011) (finding waiver of privilege in interview memoranda for five witnesses where attorneys orally disclosed to the SEC facts contained in the interviews).

103 *See, e.g., In re Pacific Pictures Corporation*, 679 F.3d 1121 (9th Cir.2012) (rejecting preservation argument as "undermin[ing] the public good of promoting an efficient judicial system by fostering uncertainty and encouraging litigation"); *In re Columbia/HCA Healthcare Corporation Billing Practices Litigation*, 293 F.3d 289 (6th Cir.2002) (waiving privileges despite confidentiality agreement with DOJ); *Westinghouse Electric Corporation v. Republic of the Philippines*, 951 F.2d 1414, 1429-1430 (3d Cir.1991) ("[c]reating an exception for disclosures to government agencies may actually hinder the operation of the work-product doctrine. If internal investigations are undertaken with an eye to later disclosing the results to a government agency, the outside counsel conducting the investigation may hesitate to pursue unfavorable information or legal theories about the corporation.").

104 *See, e.g., United States v. Deloitte LLP*, 610 F.3d 129, 139–40 (D.C. Cir. 2010) (although voluntary disclosure to auditors waives attorney- client privilege, it does not necessarily waive work-product protection); *Microtune*, 258 F.R.D. at 317 (disclosure to outside auditors waives attorney-client privilege); *Brady*, 238 F.R.D. at 439–40 ("disclosure of privileged information directly to a client's independent auditor . . . destroys confidentiality" and therefore constitutes a waiver).

105 *See, e.g., Deloitte LLP*, 610 F.3d at 139–40 (holding disclosure of work-product protected documents to independent auditors did not waive privilege and noting "[t]o the best of our knowledge, no circuit has addressed whether disclosing work-product to an independent auditor constitutes waiver. Among the district courts that have addressed this issue, most have found no waiver"); *Lawrence E. Jaffe Pension Plan v. Household Int'l, Inc.*, 237 F.R.D. 176, 183 (N.D. Ill. 2006) (disclosure of protected materials to auditors did not constitute waiver as "[d]isclosing documents to an auditor does not substantially increase the opportunity for potential adversaries to obtain the information"). *But see Medinol v. Bos. Sci. Corp.*, 214 F.R.D. 113, 116–17 (S.D.N.Y. 2002) (work-product protection waived by disclosure to independent auditor as auditor and company "did not share 'common interests' in litigation").

106 Taking steps to bolster controls and remedy any problems that occurred should not be viewed as an admission of liability. Although unlike the Federal Rules of Evidence, in the context of SEC investigations, there is no rule that prohibits the Staff from considering the remediation when assessing whether there was misconduct, where mistakes or misconduct has occurred, it is almost always preferable to remediate promptly and comprehensively.

107 *See supra* note 94 for example of remedial actions credited in settlement with Headspin, Inc., which ultimately led to settlement with no penalty, and which Director Grewal noted to be an "excellent example" "[f]or companies wondering what types of remedial actions and cooperation might be credited by the Commission after a company uncovers fraud[.]"

108 *SEC v. Jensen*, 835 F.3d 1100, 1104 (9th Cir. 2016).

109 SEC, Listing Standards for Recovery of Erroneously Awarded Compensation, Release No. 33-11126 (Oct. 26, 2022). https://www.sec.gov/rules/final/2022/33-11126.pdf.

110 *See* SEC Speech, G. Gensler*, Prepared Remarks At the Securities Enforcement Forum* (Nov. 4, 2021), https://www.sec.gov/news/speech/gensler-securities-enforcement-forum-20211104 ("I think we should focus on bringing matters to resolution swiftly. I've asked Staff to cut back on meetings with entities that want to discuss arguments in their Wells submissions. I believe it's important for the people closest to these cases to be making decisions and eliminating unnecessary process…we expect registrants to produce materials and respond to requests promptly. An examination is not an enforcement action."); SEC Speech, *Remarks at Securities Enforcement Forum West 2022* (May 12, 2022), https://www.sec.gov/news/speech/grewal-remarks-securities-enforcement-forum-west-051222 (describing slow document productions as one of the aspects of the process that the Commission wants to work to improve "to ensure that our investigations move quickly and efficiently"); Chairman Gary Gensler, Remarks Before the Practicing Law Institute's 54th Annual Institute on Securities Regulation, *This Law and Its Effective Administration*, (Nov. 2, 2022), https://www.sec.gov/news/speech/gensler-remarks-practising-law-institute-110222?utm_medium=email&utm_source=govdelivery#_ftnref6 ("Process is about timeliness. I think we should work thoughtfully and expeditiously to bring matters to resolution.").

111 *See* Procedures Relating to the Commencement of Enforcement Proceedings and Termination of Staff Investigations, Securities ActRelease No. 5310, Exchange Act Release No. 9796, Investment Company Act Release No. 7390 (Sept. 27, 1972).

112 *See* 17 C.F.R. § 202.5(c). The Rules state further that:

> *Submissions by interested persons should be forwarded to the appropriate Division Director or Regional Director with a copy to the staff members conducting the investigation and should be clearly referenced to the specific investigation to which they relate. In the event a recommendation for the commencement of an enforcement proceeding is presented by the staff, any submissions by interested persons will be forwarded*

to the Commission in conjunction with the staff memorandum. Id.

113 *See Richman v. Goldman Sachs Grp., Inc.*, 868 F. Supp. 2d 261, 272 (S.D.N.Y. 2012) (citations omitted). One interesting data point on this front is from a 2013 study of SEC data conducted by the Wall Street Journal, which found that of the 797 individuals who received Wells notices from 2010 through 2012, 159 (or nearly 20%) were not ultimately charged. Jean Eaglesham, *SEC Drops 20% of Probes after "Wells Notice,"* Wall St. J., Oct. 9, 2013.

114 In 2015, the SEC issued guidance setting forth the considerations it purports to consider in making its forum selection. The four broad factors outlined in the written guidance do not meaningfully constrain the SEC's discretion, however. *See* SEC Enforcement Div., *Division of Enforcement Approach to Forum Selection in Contested Actions* (May 15, 2015), https://www.lw.com/thoughtLeadership/lw-sec-guidance-choice-of-venue.

115 According to the FY 21 Division of Enforcement Press Release Addendum, https://www.sec.gov/files/2021-238-addendum.pdf, in FY 2021 there were 226 civil actions and 208 standalone administrative proceedings. In FY 2015, by comparison, 75% of the pending enforcement cases were civil actions.

116 *See, e.g., Chau v. SEC*, 72 F. Supp. 3d 417, 431–36 (S.D.N.Y. 2014) (addressing constitutional challenges to SEC administrative proceedings, and concluding that, despite "legitimate" concerns about "the growth of administrative adjudication," the choice between the "two tracks on which [the SEC] may litigate certain cases . . . is a matter of enforcement policy squarely within the SEC's province"). *See also* Thaya Brook Knight, *ALJs and the Home Court Advantage*, Cato Institute (May 12, 2015), https://www.cato.org/blog/aljs-home-court-advantage; Hon. Jed S. Rakoff, U.S. District Court for the Southern District of New York, Keynote Address at the PLI Securities Regulation Institute: *Is the SEC Becoming a Law Unto Itself?* (Nov. 5, 2014), http://assets.law360news.com/0593000/593644/Sec.Reg.Inst.final.pdf (observing that, with respect to administrative proceedings, "the law in such cases would effectively be made, not by neutral federal courts, but by SEC administrative judges").

117 SEC Press Release, *SEC Adopts Amendments to Rules of Practice for Administrative Proceedings* (July 13, 2016), https://www.sec.gov/news/pressrelease/2016-142.html.

118 *Lucia v. SEC*, 138 S.Ct. 2044 (2018).

119 *Jarkesy v. SEC*, No. 20-61007 (5th Cir. 2022).

120 *See* https://www.reuters.com/legal/government/us-supreme-court-takes-up-challenge-sec-in-house-tribunal-2022-05-16/.

121 Mary Jo White, Chair, SEC, Remarks at the Council of Institutional Investors Fall Conference in Chicago, IL: *Deploying the Full Enforcement Arsenal* (Sept. 26, 2013), http://www.sec.gov/News/Speech/Detail/Speech/1370539841202 [hereinafter "Deploying the Full Enforcement Arsenal"]. For example, in 2002, the SEC publicized a $10 million civil penalty as "the largest ever levied in a Commission action against a public company for financial fraud"; today, the SEC regularly seeks monetary sanctions totaling $100 million or more. *Compare* SEC Press Release, *Xerox Settles SEC Enforcement Action Charging Company With Fraud* (Apr. 11, 2002), https://www.sec.gov/news/headlines/xeroxsettles.htm *with* NYU Pollack Center for Law & Business & Cornerstone Research, *SEC Enforcement Activity Against Public Company Defendants: Fiscal Year 2016 Update 8*, https://www.cornerstone.com/Publications/Reports/SEC-Enforcement- Activity-Against-Public-Company-Defendants-2016.pdf.

122 *See* Gurbir Grewal, SEC Speech, *PLI Broker/Dealer Regulation and Enforcement 2021*, Division of Enforcement (Oct. 6, 2021), https://www.sec.gov/news/speech/grewal-pli-broker-dealer-regulation-and-enforcement-100621.

123 *Id*. ("But this does not mean that roughly equivalent misconduct by comparable offenders should be penalized in the same amount the hundredth time it occurs as the first. Rather, to achieve the intended deterrent effect, it may be appropriate to impose more significant penalties for comparable behavior over time.").

124 SEC Addendum to Division of Enforcement Press Release, Fiscal Year 2022, https://www.sec.gov/files/fy22-enforcement-statistics.pdf. This included over $4.1 billion in penalties and over $2.2 billion in disgorgement. *Id.*

125 15 U.S.C. §§ 77h-1(g), 77t(d), 78u-2(b).

126 *See* SEC, Inflation Adjustments to the Civil Monetary Penalties Administered by the Securities and Exchange Commission (as of January22, 2022), https://www.sec.gov/enforce/civil-penalties-inflation-adjustments.htm (17 C.F.R. pt. 201), Release Nos. 33-11021; 34-93925; IA-5938; IC-34466, (Jan. 6, 2022), https://www.sec.gov/rules/other/2022/33-11021.pdf. By law, the maximum amount of civil monetary penalties under the Securities Act of 1933, the Securities Exchange Act of 1934, the Investment Company Act of 1940, the Investment Advisers Act of 1940, and certain penalties under the Sarbanes-Oxley Act of 2002 are periodically adjusted for inflation. The new adjustments apply to violations occurring after November 2, 2015. Violations occurring on or before November 2, 2015, would be subject to different, slightly lower penalty rates. *See* Release Nos. 33-10276; 34-79749; IA-4599; IC-32414 (Jan. 18, 2017).

[127] *Kokesh v. SEC*, 37 S. Ct. 1635, 1642-1643 (2017).

[128] *Liu v. SEC*, 140 S. Ct. 1936, 1947 (2020).

[129] William M. (Mac) Thornberry Defense Authorization Act for Fiscal Year 2021, H.R. 6395, 116th Cong. (2020) ("NDAA") § 6501 (a)(1)(B)(ii) (to be codified as 15 U.S.C. § 78u(d)(3)(A)(ii), (d)(7)), https://www.congress.gov/bill/116th-congress/house-bill/6395.

[130] *See id.*

[131] 15 U.S.C. § 78u(d)(5); *Liu v. SEC*, 140 S.Ct. 1936, 1940 (2020).

[132] "NDAA" § 6501 (a)(1)(B)(ii) (to be codified as 15 U.S.C. § 78u(d)(3)(A)(ii), (d)(7)).

[133] 15 U.S.C. § 78j(b)).

[134] 15 U.S.C. § 77q(a)(1)).

[135] 15 U.S.C. § 80b-6(1)).

[136] *See* NDAA § 6501 (a)(8)(A)(i) (to be codified as 15 U.S.C. § 78u(d)(8)(A)(i)).

[137] *Id*.

[138] *See SEC v. Razmilovic*, 738 F.3d 14, 31–32 (2d Cir. 2013); *SEC v. Platforms Wireless Int'l Corp.*, 617 F.3d 1072, 1096 (9th Cir. 2010); *SEC v. First City Fin. Corp.*, 890 F.2d 1215, 1230–32 (D.C. Cir. 1989).

[139] *See* Securities Act Release No. 5337, Exchange Act Release No. 9882, Investment Company Act Release No. 7526 (Nov. 28, 1972) (codified at 17 C.F.R. §202.5(e)).

[140] *See, e.g., SEC v. Sierra Brokerage Servs. Inc.*, 608 F. Supp. 2d 923, 969–70 (S.D. Ohio 2009); *SEC v. Bilzerian,* 814 F. Supp. 116, 123 (D.D.C. 1993).

[141] *SEC. v. First Jersey Sec., Inc.*, 101 F.3d 1450, 1477 (2d Cir. 1996).

[142] Public Statement, Robert Khuzami, Director, SEC Division of Enforcement, *Public Statement by SEC Staff: Recent Policy Change* (Jan. 7,2012), https://www.sec.gov/news/public-statement/2012-spch010712rskhtm.

[143] *See* White, Deploying the Full Enforcement Arsenal, *supra* note 121; Kara Scannell, *SEC Considers Policy Shift on Admissions of Wrongdoing*, Fin. Times, June 18, 2013, http://www.ft.com/ content/7a93d5dc-d882-11e2-b4a4-00144feab7de.htm.

[144] *See* Alison Frankel, *Should Defendants Fear New SEC Policy on Admissions in Settlements?*, Reuters, June 19, 2013, http://blogs.reuters.com/alison-frankel/2013/06/19/should-defendants-fear-new-sec-policy-on-admissions-in-settlements/.

[145] *Id*.

[146] *Id*.

[147] *See* G. Patti, P. Robau, Admissions of Guilt to the SEC under Chair Jay Clayton (Jan. 19, 2021), (https://wp.nyu.edu/compliance_enforcement/2021/01/19/admissions-of-guilt-to-the-sec-under-chair-jay-clayton/#_ftnref8.

[148] Gurbir Grewal, Director, Division of Enforcement, *Remarks at SEC Speaks 2021* (Oct. 13, 2021).

[149] *Id*.

[150] *See, e.g., United States v. Brekke*, 97 F.3d 1043, 1049 (8th Cir. 1996); *Lipsky v. Commonwealth United Corp*., 551 F.2d 887, 893–94 (2d Cir. 1976); *In re Cenco, Inc. Sec. Litig.*, 529 F. Supp. 411, 415–16 (N.D. Ill. 1982).

[151] The analysis is contingent on various factors, including the type of settlement and how a party might attempt to make use of the settlement, or certain aspects thereof, in a subsequent proceeding. Two competing federal rules of evidence are in play: Rule 408, which generally prohibits the admission of settlement information for purposes of establishing liability; and Rule 803(8)(C), which allows the admission of public records of public agencies setting forth factual findings resulting from a lawful investigation. *Compare Option Res. Grp. v. Chambers Dev. Co.*, 967 F. Supp. 846, 849 (W.D. Pa. 1996) (finding that the Commission's factual findings, including its opinions and conclusions, contained in the settled administrative orders were admissible under Rule 803(8)(C)), *with Carpenters Health & Welfare Fund v. Coca-Cola Co.*, No. 1:00-CV-2838-WBH, 2008 U.S. Dist. LEXIS 112503, at *19–20 (N.D. Ga. Apr. 23, 2008) (finding that SEC cease and desist order against the defendant was not admissible under Rules 408 and 803(c)), *and SEC v. Pentagon Capital Mgmt. PLC*, No. 08 Civ. 3324, 2010 U.S. Dist. LEXIS 25092, at *2–4 (S.D.N.Y. Mar. 11, 2010) (finding that factual findings contained in SEC settled orders relating to third-parties were admissible under Rule 803(c)).

[152] 17 C.F.R. § 230.405.

[153] *Id*.

[154] *Id*.

[155] *See* SEC, Div. of Corp. Fin., *Revised Statement on Well-Known Seasoned Issuer Waivers* (Apr. 24, 2014), https://www.sec.gov/divisions/ corpfin/guidance/wksi-waivers-interp-031214.htm.

[156] *Id*.

[157] *Id*.

[158] *See* 17 C.F.R. § 230.506(b).

[159] *See* Disqualification of Felons and Other ''Bad Actors'' From Rule 506 Offerings, 78 Fed. Reg. 44,730, (July 24, 2013); 17 C.F.R. § 230.506.

[160] *See* 17 C.F.R. § 230.262; 17 C.F.R. § 230.506. In addition, Rule 602 of Regulation E also allows public companies to seek a waiver upon a showing of good cause that waiver is not necessary; however, the Commission has not delegated this authority, requiring public companies to appeal directly to the Commission for a Regulation E waiver. 17 C.F.R. § 230.602.

[161] *See* 17 C.F.R. § 230.262; 17 C.F.R. §§ 230.505, 230.506.

[162] *Id*.; SEC, Div. of Corp. Fin., *Process for Requesting Waivers of "Bad Actor" Disqualification Under Rule 262 of Regulation A and Rules 505 and 506 of Regulation D*, http://www.sec.gov/divisions/corpfin/guidance/262-505-waiver.htm (last modified Mar. 13, 2015).

[163] *See, e.g.*, Public Statement, Kara M. Stein, SEC Commissioner, *Statement in the Matter of JPMorgan Chase Bank, N.A., Regarding OrderUnder 506(d) of the Securities Act of 1933 Granting a Waiver of the Rule 506(d)(1)(iii) Disqualification Provision* (Dec. 18, 2015), https:// www.sec.gov/news/statement/statement-on-jpmorgan-chase-bank-12-18-2015.html ("During my tenure, I have been repeatedly concernedabout the binary nature of granting or denying waivers.").

[164] 15 U.S.C. §§ 77z-2, 78u-5.

[165] *See* 15 U.S.C. §§ 77z-2(b)(1)(A)(ii), 78u-5(b)(1)(A)(ii).

[166] 15 U.S.C. §§ 77z-2(g), 78u-5(g).

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