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What does the SEC have in store for 2020?

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For the most part, the Securities and Exchange Commission's Enforcement agenda does not change radically from year to year. And indeed, according to the SEC's most recent statistics, with some limited variation 2019 looked a lot like 2018 in terms of the total number of standalone cases brought (525 versus 490), the number of investment adviser cases (191 versus 108), issuer reporting and audit cases (92 versus 79), insider trading cases (30 versus 51), and FCPA cases (18 versus 13).

However, against that fairly predictable pattern, a number of factors — such as market trends, SEC initiatives, rule changes, and significant court cases — can push the SEC's Enforcement Division in one direction or another.

Here, we look at a number of subjects that are likely to arise in 2020 Enforcement actions due to events in 2019.

Disgorgement Under Fire

The Supreme Court has had an enormous impact on the SEC's Enforcement agenda in recent years, and 2020 will be no different.

In November, the Supreme Court agreed to hear the appeal of Charles Liu and Xin Wang, against whom the SEC obtained a $35 million judgment. Liu and Wang argue that the SEC has no authority to seek disgorgement in federal court, and there is a decent chance the Supreme Court will agree in *Liu v. SEC*.

The SEC accused the defendants of defrauding Chinese investors out of money that was supposed to be used for an EB-5 immigrant investor program. The issue to be decided would impact every case the SEC brings in federal court in which the SEC seeks disgorgement of ill-gotten gains.

How did we get here? In 2017, in *Kokesh v. SEC*, the Supreme Court said the SEC must bring disgorgement claims within five years of the underlying conduct. The impact has been enormous. According to the SEC's most recent annual report, the Enforcement Division "estimates that the *Kokesh* ruling has caused the Commission to forgo approximately $1.1 billion dollars in disgorgement in filed cases."

During the oral argument in the *Kokesh* case, several justices began asking a question that neither party had presented: whether federal courts even had the authority to grant a disgorgement request by the SEC. In the end, the Supreme Court ruled in *Kokesh* that a five-year statute of limitations applies to disgorgement claims, and the court merely observed in a footnote that it was not deciding "whether courts possess authority to order disgorgement in SEC enforcement proceedings or … whether courts have properly applied disgorgement principles in this context."

Now in *Liu*, three years after *Kokesh*, the Supreme Court has decided to squarely address the question left unanswered in 2017. If the court concludes that federal courts cannot award disgorgement in SEC Enforcement actions, that decision will have multibillion-dollar repercussions.

As with most years, 2020 will probably see about 500 total new SEC Enforcement actions filed, and most of those cases will involve roughly the usual mix of investment adviser, securities offering, insider trading, broker dealer, financial reporting/auditing, and FCPA matters.

ALJs Constitutionality Challenges Continue

Another Supreme Court issue — this time from a 2018 case — will be back in 2020: the constitutionality of SEC administrative law judges. In *Lucia v. SEC*, the Supreme Court ruled that the manner in which the SEC appointed its ALJs violated the Constitution's appointments clause.

After the Supreme Court declared the SEC ALJs unconstitutional, the SEC changed the way its ALJs were appointed and pushed forward with its administrative proceedings.

At least two of the respondents in those proceedings — Raymond Lucia in Los Angeles and Michelle Cochran in Dallas — are now raising a separate constitutional issue discussed but unresolved in *Lucia*: whether the Constitution prohibits the statutory removal protections provided for ALJs under which only the Merit Systems Protection Board can remove ALJs for good cause.

Cochran was initially rebuffed on her removal challenge by the ALJ presiding over her proceeding, and she failed again with the same argument in federal district court in Texas in April of last year. However, her appeal to the 5th U.S. Circuit Court of Appeals gained traction in October when a three-judge panel preliminarily enjoined the SEC's administrative proceeding.

A 5th Circuit ruling in Cochran's favor would deal a serious blow to the SEC's Enforcement program that would not be as easy to fix as the appointments clause issue raised in *Lucia*. And Lucia's similar challenge to his administrative proceeding in Los Angeles will be presented to the 9th Circuit in 2020. This time next year, we may be discussing a circuit split headed for the Supreme Court in 2021.

In light of other infirmities in the SEC administrative process

— such as the SEC's complete discretion to deny certain defendants access to a jury simply by choosing to bring an action administratively rather than in federal court — SEC administrative proceedings promise to be a recurring topic in the courts for years to come.

Regulation FD Revival?

After a long absence of such cases, in August the SEC imposed a $200,000 penalty and settled a Regulation FD proceeding against a Florida pharmaceutical company for allegedly sharing "material, nonpublic information with sell-side research analysts without also disclosing the same information to the public."

That the SEC would bring a Reg FD case in August 2019 is remarkable in light of the abrupt scaling back of aggressive Reg FD enforcement following the dramatic 2005 SEC loss in the first contested Reg FD case, *SEC v. Siebel Systems*. The *Siebel* court in the Southern District of New York criticized the SEC's approach which "places an unreasonable burden on a company's management and spokespersons to become linguistic experts, or otherwise live in fear of violating Regulation FD should the words they use later be interpreted by the SEC as connoting even the slightest variance from the company's public statements" which could have "a potential chilling effect which can discourage, rather than encourage, public disclosure of material information."

The SEC chose not to appeal the *Siebel* decision because, as one SEC commissioner said in a later speech, "We took off our amateur psychologist hats, put away our microscopes and went home rather than appealing that decision." By not appealing *Siebel*, the SEC also avoided circuit court scrutiny of Reg FD's constitutionality and statutory authorization, which had been raised by the company but not decided by the lower court.

After *Siebel*, the SEC didn't bring another Reg FD case for years and has rarely used the regulation in Enforcement actions since that loss. The SEC's August Reg FD case may or may not signal a return to the commission putting on its "amateur psychologist hats," but a resurgence of Reg FD cases could resurrect fears of "chilling effects" on public disclosure and a re-examination of the regulation's constitutionality.

Expanding Accredited Investor Definition

Not all Enforcement harbingers come from the courts. One example is a proposed rule change that may alter the makeup of SEC Enforcement actions: the December 18 proposed expansion of the definition of "accredited investors."

For decades, many private placement investments have been off-limits to investors who did not meet the "accredited investor" definition (individuals who make more than $200,000 per year ($300,000 for married couples) or who have a net worth of more than $1 million). The proposed amendments will "allow more investors to participate in private offerings by adding new categories of natural persons that may qualify as accredited investors based on their professional knowledge, experience, or certifications," according to the SEC's release announcing the proposal.

SEC Commissioner Hester Pierce commented on the proposal by noting, "Our current definition includes investors that spend their days cruising around in a Ferrari that Daddy bought them, yet excludes investors whose weeks are spent earning money and weekends are spent figuring out how best to invest it." Assuming the amended rule becomes effective in 2020, and the pool of accredited investors expands, that may increase the number of private securities offerings and thereby impact the number and nature of Enforcement actions the SEC brings in that area.

Scrutiny of Environmental, Social and Governance Investments

In December, the Wall Street Journal reported on an initiative out of the SEC's Los Angeles Office of Compliance Inspections and Examinations inquiring into funds that pursue strategies to address environmental, social or governance issues such as climate change. According to the report, the SEC is asking investment managers pursuing ESG strategies for a list of recommended stocks, models for judging which companies are environmentally or socially responsible, and the best- and worst-performing ESG investments.

For investment advisers, many issues first identified by the OCIE examination staff later end up as the subject of Enforcement inquiries and litigation, so 2020 may see Enforcement actions involving investment advisers in the ESG area.

2020's Enforcement Landscape

As with most years, 2020 will probably see about 500 total new SEC Enforcement actions filed, and most of those cases will involve roughly the usual mix of investment adviser, securities offering, insider trading, broker dealer, financial reporting/auditing, and FCPA matters. SEC initiatives, rule changes, and market trends such as ESG investing and broader access to private offerings will have a modest impact on Enforcement numbers. More fundamentally, the SEC Enforcement landscape has the potential for significant change as a result of the challenges to the SEC's federal court disgorgement authority and the administrative hearing process. ■

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