Cooley

New SEC Leadership to Focus on Enforcement

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What happened

President Joe Biden announced that he would nominate Gary Gensler to serve as the next chairman of the US Securities and Exchange Commission. Gensler formerly served as head of the Commodity Futures Trading Commission, where he developed a reputation as a tough regulator in the wake of the financial crisis. This change in leadership at the SEC will likely herald an increased focus on enforcement matters.

Corporate disclosure and financial reporting investigations have always been a key feature of the SEC's mission. Under the leadership of former Chairman Jay Clayton, the SEC was criticized by some policymakers as not being tough enough. Given the profile of new leadership, recently passed legislation that expands the SEC's authority and increases its budget and the likely priorities of a Democratic-controlled government, corporations should be prepared for a better resourced and more aggressive SEC Division of Enforcement, with a renewed focus on investigating perceived misconduct at both publicly traded and emerging companies.

Why it matters for public companies

The SEC has traditionally considered public company disclosure cases an area of focus, and this focus should intensify under the new administration. With more resources, the Division of Enforcement will open more investigations into public companies.

One likely area of increased scrutiny will be the conduct and culpability of senior executives. Under the outgoing leadership, CEOs were charged in about one-third of the SEC's public company cases and CFOs were charged at a similar rate. New leadership will likely empower the Division of Enforcement staff to pursue more cases against senior executives, using creative legal tools in the agency's toolbox to charge those individuals even when there is no evidence of fraud, rather than charging only the company.

More broadly, to prove the agency's renewed commitment to policing public companies, new leadership will likely rely on lesser charges and creative factual theories to bring more cases. The SEC has long had the ability to bring negligence-based fraud charges against public companies and executives where, presumably, the evidence did not support knowing or reckless fraud. It has traditionally threatened companies with intentional fraud charges as a means of getting them to settle ultimately to negligence-based fraud charges. Cases that result in negligence-based fraud charges are no less expensive to defend, and like intentional fraud cases, they also cause reputational damage and often include significant monetary penalties. For example, the SEC's settled actions against General Electric ($200 million penalty), Yahoo ($35 million penalty), Walgreens ($34.5 million penalty), Mylan ($30 million penalty) and Super Micro Computer ($17.5 million penalty) were all negligence-only matters. As the SEC's new leadership seeks to prove it is more aggressive than its predecessor, we are likely to see the agency willing to pursue more marginal cases and ultimately seek more settlements and/or bring more litigated actions charging only negligence. Finally, even in the absence of negligence, the agency will likely bring more strict liability charges against public companies, including reporting, books and records and internal controls violations.

In addition, US Congress recently passed the National Defense Authorization Act, which authorizes the SEC to seek disgorgement and extends its statute of limitations period from five to 10 years. After a series of US Supreme Court decisions seen as limiting the SEC's authority, these changes dramatically expand the potential relief the SEC can seek and will expand the scope and cost of its investigations. At the same time, one can expect that, as under prior administrations, the SEC will push for higher penalties from corporations.

We expect that under the new administration, the SEC will use its expanded authority and resources to more aggressively pursue securities violations at public companies. In the near term, we expect particular scrutiny of high-visibility tech companies, life sciences companies under the microscope in the age of COVID-19 and post-IPO companies experiencing rapid growth.

Why it matters for private companies

Under the last Democratic administration, the SEC announced its **Silicon Valley Initiative**, which included a focus on the accuracy of disclosures made by pre-IPO unicorns. This focus bore some fruit under the outgoing SEC leadership, as the agency brought several enforcement actions against prominent venture-backed companies and funds in the last few years. To date, the SEC has brought fraud charges against multiple founders, deployed Rule 701 to penalize a company for failing to provide employees with financial statements in connection with stock options grants and charged various individuals (including venture fund principals) in connection with pre-IPO investment management and advice.

Enforcement activity in this space will likely increase under new SEC leadership. High-visibility pre-IPO tech companies continue to attract sizeable investments and make frequent media headlines. Also, an ever-growing pool of investors – including retail investors – have exposure to these companies' securities. To show that it is keeping this area safe for investors, the SEC is likely to bring more actions. All of this adds up to an increased risk of costly SEC enforcement investigations, which can create significant headwinds for emerging companies scaling quickly.

Conclusion

For questions or more information on SEC enforcement matters, please contact a member of Cooley's white collar defense and investigations and securities litigation groups. For more content on the public securities arena, please visit **Cooley PubCo**.

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