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## DEPARTMENTS




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# INSIGHTS

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## PROXY SEASON

# Shareholder Proposal No-Action Requests in the 2021 Proxy Season

*The 2021 proxy season was unusual given the backdrop of the pandemic and social unrest. The lack of Staff response letters creates continuing uncertainty, but there were some developments that confirm the need for companies to continue to scrutinize shareholder proposals to determine whether to include them in proxy materials.*

*By Marc S. Gerber and Ryan J. Adams*

As calendar year-end companies received shareholder proposals for their 2021 annual meetings, they faced a variety of uncertainties and challenges, including navigating the COVID-19 pandemic, addressing the racial inequities brought to the fore by the killings of George Floyd and others, and steering through a hyper-partisan and unprecedented US presidential transition. The shareholder proposals received by companies reflected many of these broad themes.

Unlike in the prior three years, the Staff of the Division of Corporation Finance (Staff) of the US Securities and Exchange Commission (SEC) did not issue new guidance regarding companies' ability to exclude shareholder proposals from their proxy statements heading into the 2021 season. Although this may have hinted at some stability in the no-action process, that was not to be the case. The Staff issued significantly fewer no-action response letters than in previous years, opting instead to respond mostly through informal decisions that were included in a chart on the SEC's website. Because these informal responses provided the Staff's conclusions without additional explanation, the Staff's reasoning in a number of decisions was unclear.

Nevertheless, whether by response letter or chart entry, there were a number of notable no-action decisions and trends. As in prior years, many of these concerned the ability to exclude proposals as relating to a company's ordinary business. In addition, some related to procedural items that might have seemed fairly straightforward. Reviewing the guideposts provided by Staff decisions from the 2021 proxy season helps in attempting to understand the Staff's current approach to shareholder proposals.

## Despite Increased Success of Board Analyses, Numbers Do Not Tell the Full Story

Building on past experience, the number of no-action requests containing a board analysis increased slightly year-over-year, and the number of such requests granted increased significantly. Based on informal responses, it appears that companies successfully used board analyses in no-action requests under the ordinary business, relevance and substantial implementation exclusions during the 2021 proxy season.[1] As described below, however, most of these successful requests followed paths carved in the 2020 proxy season and broke little new ground. Also, as in prior years, the Staff denied some requests for no-action relief despite the presence of a board analysis, serving as a reminder that even a well-informed board analysis will not always carry the day.

### Ordinary Business

In two instances, the Staff concurred with a company's view that a proposal could be excluded as ordinary business, and while each no-action request

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contained a board analysis, it was not obvious that a board analysis was necessary for relief and the Staff's charted responses did not indicate whether the board analysis impacted the Staff's view.[2]

In two other instances, the Staff concurred with ordinary business arguments containing a board analysis to exclude proposals requesting a report on the potential risks associated with omitting the terms "viewpoint" and "ideology" from the company's equal employment opportunity policies.[3] The Staff did not issue no-action letters in these instances, but the companies' arguments aligned with those from a successful no-action request in the 2020 proxy season in which the Staff issued a no-action response letter citing the company's board analysis.[4] It may be the case that the Staff will not issue formal no-action responses when a board analysis included in a request aligns with one it previously found persuasive.

**Relevance**

It continues to be the case that most of the successful board analyses under the relevance grounds for exclusion relate to proposals that may not be widely applicable. For instance, in the 2020 proxy season, one of the successful relevance board analyses related to wild animal displays. This proxy season, the successful board analysis involved a large insurance company arguing to exclude a proposal requesting a report on how the company could reduce the potential for "racist police brutality" through its products.[5] After demonstrating that the proposal's subject matter was not economically significant to the company, the company submitted an analysis from its nominating and corporate governance committee that concluded the proposal was not otherwise significant to the company. The committee's analysis noted, among other factors, that the proposal's significance to the company's business was not apparent on its face and that shareholders had not previously raised the issue in the proposal. The Staff responded without a letter, granting relief under the relevance exclusion.

In a contrasting example, a large financial institution unsuccessfully argued that a proposal seeking disclosure of the company's lobbying payments was not relevant to the company's business.[6] As above, after explaining that the proposal's subject matter was not economically significant to the company, the company submitted an analysis from its nominating and corporate governance committee that concluded the proposal was not otherwise significant to the company. It noted that shareholder support for similar proposals had declined from approximately 30% of votes cast in 2017 to approximately 15% in 2020. In a previous season, the Staff denied a relevance argument by the same company for a similar proposal, noting at the time that the company's board analysis failed to adequately address prior voting results.[7] Again, the Staff denied the request, this time without issuing a letter.

**Substantial Implementation**

The majority of no-action letters granted during the 2021 proxy season that included a board analysis were granted under the substantial implementation exclusion. Staff guidance on board analyses had not indicated that a board analysis could be helpful outside the ordinary business or relevance grounds for relief, but the Staff opened the door to this approach in the 2020 season. To date, all of the successful examples of a board analysis used to support a substantial implementation argument relate to proposals seeking a review of how a company could implement the Business Roundtable's "Statement on the Purpose of a Corporation." In the 2020 proxy season, the Staff issued a response letter granting relief under the substantial implementation basis where the company noted that its nominating and corporate governance committee concluded that no additional actions or assessments were required to implement the proposal.[8] While that request also featured a robust ordinary business argument, many of the successful no-action requests on this proposal topic in the 2021 proxy season skipped the ordinary business argument and only argued for substantial implementation, with the board analysis largely following the reasoning of the 2020 letter.

Whether a board analysis can successfully support a substantial implementation argument for any other proposal topic remains to be seen. Notably, the Staff denied no-action relief where a company sought to exclude a proposal seeking a racial equity audit, arguing that it had substantially implemented the proposal and noting the conclusion of its corporate governance and nominating committee that the company already had taken the actions requested by the proposal.[9]

## Ordinary Business: Spotlight on 'Significance'

In Staff Legal Bulletin (SLB) 14K, the Staff reminded companies and shareholder proponents that it evaluates a proposal's significance under the ordinary business exclusion on a company-specific basis, and "a policy issue that is significant to one company may not be significant to another." In doing so, the Staff explicitly rejected the notion of "universally" significant topics. In a proxy season generating only a small number of no-action letters, it is notable that the topic of universal significance specifically came up in two response letters. This serves as an important reminder to companies that regardless of any notion of the significance of a topic to society at large, the relevant analysis is whether the proposal relates to a topic of actual significance to the company.

In one instance, a large retailer successfully argued that a proposal asking for a report on the feasibility of giving "paid sick leave … as a standard employee benefit not limited to COVID-19" related to the company's ordinary business and was not significant to the company.[10] The Staff issued a response letter noting that proposals related to paid sick leave "may" raise a significant policy issue, but the proposal "does not demonstrate how offering paid sick leave as a standard employee benefit is sufficiently significant to [this] Company" and, citing SLB 14K, the Staff "does not recognize particular issues or categories of issues as universally 'significant.'"

In another instance, a retail pharmacy company successfully argued that a proposal requesting a report on the "external public health costs" created by the company's retail food business was excludable under the ordinary business exception and was not significant to the company.[11] The Staff granted the no-action request without issuing a letter. Shortly before deciding the request, the Staff denied relief for a nearly identical proposal submitted to a large food and beverage manufacturer, also without issuing a letter.[12] The proponent of the proposal at the retail pharmacy company requested reconsideration, noting that the two proposals were nearly identical and related to many of the same products. In denying the reconsideration request, the Staff wrote that while a proposal "may raise a significant policy issue that transcends a company's ordinary business operations" (citing the no-action decision at the food and beverage manufacturer), the proposal at the retail pharmacy "does not demonstrate how external public health costs created by the Company's retail food business are sufficiently significant to the Company."

## The Waning Success of the Micromanagement Prong of Ordinary Business

The micromanagement prong of the ordinary business exclusion experienced a resurgence over the past few years, although Staff guidance in SLB 14K provided a road map for proponents to evade these arguments. Accordingly, the number of successful no-action requests premised on micromanagement declined in the 2020 proxy season. This downward trend continued in the 2021 season, with both the number and success of such requests declining.

As the Staff explained in SLB 14K, when considering arguments for exclusion based on micromanagement the Staff often assesses the level of prescriptiveness with which a proposal addresses a subject. Examples of proposals excluded on the basis of micromanagement from the 2021 proxy season include a proposal that would have required the company to include diverse candidates in the initial candidate pool for hiring for all positions at the company,[13] another that would reduce CEO pay ratio by a specified amount,[14] and another to prohibit equity compensation grants to senior executives when the company's common stock fell below a particular price.[15]

Interestingly, the Staff denied relief for a proposal requesting an energy company set reduction targets for the greenhouse gas emissions of its operations and energy products (Scope 1, 2 and 3).[16] The company argued the proposal impermissibly micromanaged the company by requesting it adopt greenhouse gas emission reduction targets and compared the proposal to past examples where the Staff permitted exclusion of proposals seeking greenhouse gas emissions targets aligned with the Paris Climate Agreement. The Staff denied relief, stating in a response letter that "the Proposal only asks the Company to set emission reduction targets; it does not impose a specific method for doing so." Going forward, it is not clear where the Staff will draw the line between proposals prescriptive enough to qualify as micromanagement and those that are not, allowing them to survive a challenge.

Despite the guidance in SLB 14K that micromanagement determinations focus on the manner in which a proposal seeks to address an issue rather than the subject matter itself, decisions from the 2021 proxy season continue a trend from the 2020 season. They suggest that micromanagement arguments may not be viable in the context of corporate governance proposal topics, even with apparently prescriptive requests. For example, the Staff rejected an argument that a proposal requesting a company amend its certificate of incorporation to convert from a Delaware corporation to a public benefit corporation was overly prescriptive.[17] The Staff also rejected a micromanagement argument where the proposal would have required a company to implement a policy that the initial list of candidates for new director nominees include nonmanagement employees.[18]

## Some Surprising Procedural Decisions

Although the 2021 proxy season saw an increased percentage of proposals excluded on procedural grounds, in two instances, with formal response letters, the Staff denied no-action relief due to circumstances relating to COVID-19.

In one instance, a company argued that a proposal could be excluded because the proponent failed to timely respond to a deficiency notice relating to its delegation of authority.[19] The proponent had submitted the proposal to the company by UPS and email and requested further communications be sent to the proponent by email. The company sent a deficiency notice to the proponent's offices by UPS and did not receive a response within the 14-day period following delivery because the proponent's offices were closed due to COVID-19. After becoming aware of the deficiency notice, the proponent responded within two business days. In denying the company's request for no-action relief due to the lack of a timely response to the deficiency letter, the Staff wrote that the proponent's failure to timely correct the deficiency "related to the COVID-19 pandemic and the Proponent's representative responded reasonably after discovering the notice." The Staff specifically noted that the proponent's "initial submission requested communications to be directed to a particular email address, but the Company sent its deficiency notice to the offices of the Proponent's representative via UPS only, and did not otherwise inform the Proponent by email of the mailed deficiency notice."

In another instance, the Staff did not concur with a company's argument that a proposal was untimely when it was delivered to the company's offices six days after the deadline.[20] Typically, proponents must ensure a proposal's timely submission, and delivery even one day past the deadline is sufficient for exclusion. In its response letter, the Staff noted:

> Our decision to deny relief is based on the significant and well known delivery delays incurred by the United States Postal Service

> due to the pandemic and surge in holiday deliveries, which were outside the control of the Proponent.

Interestingly, the original anticipated delivery date for the proposal was only one day before the deadline. Whether this decision indicates a more generous approach to timeliness issues by the Staff remains to be seen.

This letter also provided the Staff an opportunity to comment on the use of email for proposal submissions. The Staff noted that while the proponent unsuccessfully attempted to submit the proposal by email, the Staff based its decision only on the proposal's submission to the physical address provided in the company's proxy statement. On using email, the Staff stated:

> To the extent a proponent faces obstacles to timely delivery to a mailing address beyond its control and seeks to submit the proposal by an alternate means not provided for in the proxy statement, the proponent should first contact the company to obtain any approved, alternate means for submitting proposals. The proponent also should request that a company employee confirm that the company received the proposal given the proponent bears the burden of proving the date of delivery.

## Conclusion

Against the backdrop of the pandemic and social turmoil, the 2021 proxy season was by no means ordinary. The lack of Staff response letters will create continuing uncertainty as companies consider future shareholder proposals. Nevertheless, numerous developments—including the success of no-action requests containing board analyses, the Staff responses highlighting that proposal topics are not universally "significant" and the continuing (if decreasing) viability of micromanagement arguments—confirm that companies should continue scrutinizing shareholder proposals to ascertain whether to include them in proxy materials.

### Notes

1. As a brief reminder, the Staff introduced the concept of including a board analysis to support shareholder proposal no-action requests in Staff Legal Bulletin No. 14I. Specifically, the Staff indicated that a board analysis could be helpful to the Staff in making determinations to exclude proposals relating to the company's "ordinary business" under Rule 14a-8(i)(7) or as lacking "relevance" to the company under Rule 14a-8(i)(5). One year later, in Staff Legal Bulletin No. 14J, the Staff provided further guidance regarding the types of factors that a "well-developed" board analysis might address. In the next year, the Staff expanded its guidance on two particular factors of a board analysis in Staff Legal Bulletin No. 14K – the "delta" analysis and prior voting results.
2. *See* Verizon Communications Inc. (Mar. 2, 2021); State Street Corp. (Mar. 26, 2021).
3. *See* American Express (Feb. 26, 2021); Walgreens Boots Alliance, Inc. (Nov. 25, 2020).
4. Compare with Apple Inc. (Dec. 20, 2019), Alphabet Inc. (Apr. 9, 2020) and salesforce.com (Apr. 9, 2020).
5. *See* Chubb Limited (Mar. 26, 2021).
6. *See* Citigroup Inc. (Feb. 26, 2021).
7. *See* Citigroup Inc. (Mar. 6, 2018).
8. *See* JPMorgan Chase & Co. (Feb. 5, 2020).
9. *See* JPMorgan Chase & Co. (Mar 26, 2021).
10. *See* Kohl's Corp. (Feb. 19, 2021).
11. *See* CVS Health Corp. (Mar. 22, 2021) *recon denied*. (Mar. 30, 2021).
12. *See* PepsiCo, Inc. (Mar. 12, 2021).
13. *See* Amazon.com, Inc. (Apr. 9, 2021).
14. *See* Gilead Sciences, Inc. (Dec. 23, 2020).
15. *See* Rite Aid Corp. (Apr. 23, 2021) recon. denied (May 10, 2021).
16. *See* ConocoPhillips Co. (Mar. 19, 2021).
17. *See* Tractor Supply Co. (Mar. 9, 2021).
18. *See* The Walt Disney Co. (Dec. 23, 2020).
19. *See* Amazon.com, Inc. (Apr. 9, 2021).
20. *See* PRA Health Services, Inc. (Mar. 17, 2021).

## SECURITIES ENFORCEMENT

# 2021 Mid-Year Securities Enforcement Update

*In the first six months of the Biden administration a new Chair of the SEC was sworn in and a new senior staff is being put in place. We can expect to see more aggressive and proactive regulatory oversight, including in areas of ESG disclosure and investment management and special purpose acquisition companies.*

*By Mark K. Schonfeld and Tina Samata*

Mid-year 2021 marks the first six months of the Securities Exchange Commission (SEC or Commission) under the Biden administration. Change came swiftly, yet is only just beginning. It is safe to say that the next four years will see a return to increasing regulatory oversight and escalated enforcement of market participants.

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

Shortly after her appointment to the Acting Chair position, Acting Chair Lee announced changes to the enforcement process that facilitated the opening of formal investigations and also added uncertainty to the settlement process for companies and SEC registered firms. In February, Acting Chair Lee restored the delegated authority of senior Enforcement Division Staff to issue formal orders of investigation, which authorize the Staff to issue subpoenas for documents and testimony.[3] The redelegation of authority reversed the 2017 decision under the Trump administration which restricted authority to issue formal orders to the Director of the Enforcement or the Commissioners.

Acting Chair Lee cited the need to allow investigative staff "to act more swiftly to detect and stop ongoing frauds, preserve assets, and protect vulnerable investors."[4] Immediately following that pronouncement, the Commission announced an end to the practice of permitting settling parties to make contingent settlement offers—offers to resolve an investigation contingent on receiving from the Commission a waiver of collateral consequences, such as disqualifications from regulatory safe harbors, which would otherwise arise from the violations. In her statement, Acting Chair Lee noted that "waivers should not be used as 'a bargaining chip' in settlement negotiations, nor should they be considered a 'default position' under the SEC."[5] Following the announcement, Commissioners Hester Peirce and Elad Roisman, both Republicans, issued a joint statement criticizing the impact of the policy reversal on parties seeking to resolve an investigation through a settlement "because it undercuts the certainty and finality that settlement might otherwise provide."[6]

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

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

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

## Themes and Notable Developments

### Climate and ESG Task Force

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

In April, the Division of Examinations issued a Risk Alert detailing its observations of deficiencies and internal control weaknesses from examinations of investment advisers and funds regarding investing that incorporates ESG factors.[10] The Division's Risk Alert provides a useful roadmap to assist investment advisers in developing, testing and enhancing their compliance policies, procedures and practices.

### Focus on SPACs

Over the course of the first half of this year, the SEC has been intensifying its focus on SPACs. Also referred to as blank check companies, SPACs are shell companies which offer private companies an alternative path to the public securities markets instead of an IPO. A SPAC transaction proceeds in two phases: (1) an initial phase in which the shell company raises investor funds to finance all or a portion of a future acquisition of a private company, and (2) a de-SPAC phase in which the SPAC merges with a private target company. During the de-SPAC phase, investors in the initial SPAC either sell their shares on the secondary market or have their shares redeemed. After the de-SPAC, the entity continues to operate as a public company. Typically, SPACs have two years to complete a merger with a private company.

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

This enforcement action has important implications for SPACs, their sponsors, and executives for their diligence on proposed acquisition targets. To emphasize the point, SEC Chair Gensler took the unusual step of providing comments that echoed the concerns of senior officials and sent a clear message that even when the SPAC is "lied to" by the target, the SPAC and its executives are at risk for liability under the securities laws if their diligence fails to uncover misrepresentations or omissions by the target. Chair Gensler stated:

> This case illustrates risks inherent to SPAC transactions, as those who stand to earn significant profits from a SPAC merger may conduct inadequate due diligence and mislead investors. . . . The fact that [the target] lied to [the SPAC] does not absolve [the SPAC] of its failure to undertake adequate due diligence to protect shareholders.

### Focus on Cybersecurity Risks

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

### Shifting Approach to Penalties against Public Companies

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

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

*The Commission's approach to corporate penalties may be undergoing a transition.*

In an effort to bring some consistency to the Commission's and the Enforcement Division's approach to negotiating corporate penalties, in 2006 the Commission unanimously issued guidance on whether, and to what extent, the Commission should seek to impose penalties against public companies.[14] Rooting the guidance in the legislative history of the 1990 Congressional authorization of SEC penalty authority, the Commission's 2006 guidance identified two principal factors to determine whether a penalty against a public company would be appropriate: (1) whether the company received a direct financial benefit as a result of the alleged violation; and (2) the extent to which a penalty would recompense or harm injured shareholders. Although the

2006 guidance identified other relevant factors—such as the need for deterrence, egregiousness of the harm from the violation, level of intent, corporate cooperation—the first two factors were of paramount importance. As a general matter, in the years following the 2006 Guidance, the size of corporate penalties in financial reporting cases moderated.

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

*The Commission's approach to corporate penalties diverges from its statutory underpinnings.*

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

## Litigation Developments

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

## Whistleblower Awards

Coming off another record year of whistleblower awards in 2020, the Commission has continued to issue awards at a record pace in the first half of 2021. There is no reason to believe that these awards will slow down given the importance of the program to the Commission. Through June of this year, the SEC's whistleblower program has awarded nearly

$200 million to 45 separate whistleblowers. That is almost $100 million more than the first half of 2020, which was $115 million to 15 individuals. Overall, the SEC's whistleblower program has paid out approximately $937 million to 178 individuals since the start of the program.

In April, the SEC announced an award of over $50 million to joint whistleblowers for information that alerted the SEC to violations involving highly complex transactions that would have "been difficult to detect without their information."[18] This award is the second largest in the history of the program and reflects the Commission's dedication to recovering funds for harmed investors.

## Public Company Accounting, Financial Reporting and Disclosure Cases

### Financial Reporting Cases

***Cases Against Public Companies and Executives.*** In February, the SEC announced settled charges against the former CEO and CFO of a company that provides Flexible Spending Account services for allegedly making false and misleading statements and omissions that resulted in the company's improper recognition of revenue related to a contract with a large public-sector client.[19] The SEC's order alleged that one of the company's large public sector clients stated on multiple occasions that it did not intend to pay for certain development and transition work associated with an existing contract. The CEO and CFO allegedly directed the company to recognize $3.6 million in revenue related to this work without disclosing to internal accounting staff or to the company's external auditor that the client's employees denied that it owed these amounts to the company. Without admitting or denying the SEC's findings, the CEO and CFO agreed respectively to cease and desist from further violations of the charged provisions, pay penalties of $75,000 and $100,000, and reimburse the company for incentive-based compensation received on the basis of the alleged violations.

In May, the SEC instituted a settled action against a sports apparel manufacturer for allegedly misleading investors as to the bases of its revenue growth and failing to disclose known uncertainties concerning its future revenue prospects.[20] The SEC's order alleged that the company accelerated, or "pulled forward," a total of $408 million in existing orders that customers had requested be shipped in future quarters and that the company attributed its revenue growth during the relevant period to a variety of other factors without disclosing to investors material information about the impact of its pull forward practices. The company agreed to cease and desist from further violations and to pay a $9 million penalty without admitting or denying the findings in the SEC order.

***Cases Against Auditors and Accountants.*** In February, the SEC suspended two former auditors from practicing before the SEC in connection with settled charges alleging improper professional conduct during an audit of a now defunct, not-for-profit educational institution.[21] The auditors allegedly issued an audit report without following Generally Accepted Auditing Standards by, among other things, failing to obtain sufficient appropriate audit evidence or to properly prepare audit documentation. The resultant financial statements allegedly fraudulently overstated the college's net assets by $33.8 million. Without admitting or denying the findings, the auditors agreed to the suspension with the right to apply for reinstatement after three years and one year, respectively.

In April, the SEC instituted administrative proceedings against a Texas-based CPA for allegedly failing to register his firm with the Public Company Accounting Oversight Board (PCAOB) and alleged failures in auditing and reviewing the financial statements of a public company client.[22] The CPA allegedly failed to complete his application to register with the PCAOB and performed an audit while the application was incomplete. The audit allegedly failed to comply with multiple PCAOB Auditing Standards as well. The proceedings will be scheduled for a public hearing before the Commission.

### Disclosure Cases

In February, the SEC announced settled charges against a gas exploration and production company and its former CEO for failing to properly disclose as compensation certain perks provided to the CEO and certain related personal transactions.[23] The alleged failures to disclose included approximately $650,000 in the form of perquisites, including costs associated with the CEO's use of the company's chartered aircraft and corporate credit card. The SEC took into account the company's significant cooperation efforts when accepting the settlement offer. The Company and CEO agreed, without admitting or denying to the SEC's findings, to cease-and-desist from further violations. Additionally, the CEO agreed to pay a civil penalty in the amount of $88,248.

In April, the SEC instituted a settled action against eight companies for allegedly failing to disclose in SEC Form 12b-25 "Notification of Late Filing" forms (known as Form NT) that their requests for seeking a delayed quarterly or annual reporting filing was caused by an anticipated restatement or correction of prior financial reporting.[24] The orders found that each company announced restatements or corrections to financial reporting within four to fourteen days of their Form NT filings despite failing to disclose that anticipated restatements or corrections were among the principal reasons for their late filings. The companies, without admitting or denying the findings, agreed to cease-and-desist-orders and paid penalties of either $25,000 or $50,000.

In May, the SEC announced settled charges against a firm that produces, maintains, licenses, and markets stock market indices.[25] The SEC's order alleged failures relating to a previously undisclosed quality control feature of one of the firm's volatility-related indices, which allegedly led it to publish and disseminate stale index values during a period of unprecedented volatility. The allegedly undisclosed feature was an "Auto Hold," which is triggered if an index value breaches certain thresholds, at which point the immediately prior index value continues to be reported. Without admitting or denying the SEC's findings, the firm agreed to a cease-and-desist order and to pay a $9 million penalty.

## Investment Advisers and Broker-Dealers

### Investment Advisers

In late May, the SEC filed a civil action against two investment advisers and their portfolio managers for allegedly misleading investors about risk management practices related to their short volatility trading strategy.[26] According to the SEC's complaint, the investment advisers made misleading statements about their risk management practices. During a period of historically low volatility in late 2017, the investment adviser firms increased the level of risk in the portfolios while assuring investors that the portfolios' risk profiles remained stable. The SEC's complaint alleged that a sudden spike in volatility in early 2018 led to trading losses exceeding $1 billion over two trading days. The SEC separately settled related charges with the Firm's Chief Risk Officer.

In mid-June, the SEC announced that it had obtained an asset freeze and filed charges against a Miami-based investment professional and two investment firms for engaging in a "cherry-picking" scheme in which they allegedly channeled trading profits to preferred accounts.[27] The SEC alleged that beginning in September 2015, the firms diverted profitable trades to accounts held by relatives and allocated losing trades to other clients by using a single account to place trades without specifying the intended recipients of the securities at the time of the trade. According to the SEC's complaint, the preferred clients received approximately $4.6 million in profitable trades while the other clients experienced over $5 million in first-day losses.

### Broker-Dealer Reporting and Recordkeeping

In May, the SEC announced settled charges against a Colorado-based broker-dealer for failing to file Suspicious Activity Reports (SARs).[28] The purpose of SARs is to identify and investigate potentially suspicious activity. The SEC's order alleged that for a three-year period, the broker-dealer failed to file SARs—or filed incomplete SARs—while it was aware that there were attempts to use improperly obtained personal identifying information to gain access to the retirement accounts of individual plan participants at the broker-dealer. The SEC's order noted significant cooperation by the broker-dealer and remedial efforts including anti-money laundering systems, replacing key personnel, clarifying delegation of responsibility, and implement new SAR-related policies and training.

## Cryptocurrency and Digital Assets

### Registration Case

In May, the SEC filed a civil action against five individuals for allegedly promoting unregistered digital asset securities.[29] The defendants worked as promoters for an open-source cryptocurrency, raising over $2 billion dollars from retail investors. The SEC's complaint alleged that from January 2017 to January 2018, the promoters advertised the cryptocurrency's "lending program" by creating "testimonial" style videos that appeared on YouTube. According to the complaint, the defendants did not register as broker-dealers and also did not register the securities offering. The complaint seeks injunctive relief, disgorgement, and civil penalties from all five defendants.

### Fraud Case

In February, the SEC filed a civil action against three defendants, a founder of two digital currency companies and promoters for the companies, for allegedly defrauding hundreds of retail investors out of over $11 million through digital asset securities offerings.[30] The SEC's complaint alleged that from December 2017 to January 2018, the individuals induced investors to purchase securities in the companies by claiming their trading platform was the "largest" and "most secure" Bitcoin exchange. The defendants then promoted the unregistered initial coin offering of their cryptocurrency, referred to as B2G tokens by telling investors that their cryptocurrency would be built on the Ethereum blockchain and would launch in April 2018. Instead, the SEC claims, the defendants misappropriated the investor funds for their personal benefit. The complaint seeks injunctive relief, disgorgement, and penalties, along with an officer and director bar for the founder and one promoter. The U.S. Attorney's Office for the Eastern District of New York and the Department of Justice Fraud Section announced parallel criminal charges against the promoter.

## Insider Trading

In March, the SEC filed settled charges against a California individual for perpetuating a scheme to sell "insider tips" on the dark web.[31] This is the SEC's first enforcement action involving alleged securities violations on the dark web, a platform allowing users to access the internet anonymously. The complaint alleged that the individual falsely claimed to possess material, nonpublic information, which he sold on the dark web. Several investors purchased the individual's purported tips and traded on the information he provided. The individual agreed to a bifurcated settlement (which reserves the determination of disgorgement and penalties for a later date); the US Attorney's Office for the Middle District of Florida announced parallel criminal charges.

In June 2021, the SEC announced settled charges against a New York-based couple for insider trading relating to the stock of a pharmaceutical company where one of them worked as a clinical trial project manager.[32] According to the SEC's complaint, the project manager learned of negative results from the drug trial she oversaw, and tipped another individual who sold all of his stock in the pharmaceutical company ahead of the public news announcement. The individual also tipped his uncle, who also sold all of his stock. After the negative news was announced, the company stock fell approximately 50 percent, which would have led to losses of over $100,000 for the individuals had the individuals not sold their stock. The individuals have agreed to pay around $325,000 to settle the charges.

## Regulation FD

In the 20 years since the adoption of Regulation FD, which prohibits selective disclosure by public companies of material, non-public material information, the Commission has filed only two litigated enforcement actions alleging violation of the Rule. The first case, filed against Seibel Systems in 2005, ended swiftly when the district court granted the defendants' motion to dismiss the Commission's complaint for failure to state a claim.[33] More than 15 years later, in March of this year, the SEC filed a litigated action against AT&T and three investor relations employees.[34] The complaint alleges that the three IR employees selectively released material financial data in March and April of 2016. Specifically, the SEC alleges that the IR employees disclosed material nonpublic information to a group of analysts at twenty research firms in an effort to avoid the Company's quarterly revenue falling short of the analyst community's estimates. AT&T issued a statement in response explaining that any information discussed in communications with analysts was public and immaterial.[35] Among other things, AT&T noted that the information discussed with analysts

> concerned the widely reported, industry-wide phase-out of subsidy programs for new smartphone purchases and the impact of this trend on smartphone upgrade rates and equipment revenue.… Not only did AT&T publicly disclose this trend on multiple occasions before the analyst calls in question, but AT&T also made clear that the declining phone sales had no material impact on its earnings.

Notably, AT&T highlighted the fact that the Commission's complaint "does not cite a single witness involved in any of these analyst calls who believes that material nonpublic information was conveyed to them."

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(May 12, 2021), available at *https://www.sec.gov/news/press-release/2021-82*.

29. SEC Press Release, SEC Charges U.S. Promoters of $2 Billion Global Crypto Lending Securities Offering (May 28, 2021), available at *https://www.sec.gov/news/press-release/2021-90*.
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## SECURITIES DISCLOSURE

# Commenters Weigh in on SEC Climate Disclosures Request

*The SEC's March 2021 request for public input on climate disclosures attracted 297 institutional comments totaling 3,290 pages. The views range from questioning the SEC's authority to imploring the SEC to mandate comprehensive, internationally aligned and assured disclosures in SEC filings.*

*By Gabriel D. Rosenberg, Margaret E. Tahyar, Betty M. Huber, and Eric B. Lewin*

The Securities and Exchange Commission (SEC) took a first step toward the adoption of climate disclosure requirements by issuing a request for public input (RFPI) on March 15, 2021. The RFPI requested comments from investors, registrants and other market participants "[i]n light of demand for climate change information and questions about whether current disclosures adequately inform investors." To facilitate the SEC Staff's view of existing disclosure rules, the RFPI requested comment on fifteen questions, ranging from how the SEC could best regulate climate disclosures to whether the SEC should expand its focus from climate disclosures alone to a focus on environmental, social and governance (ESG) matters as part of a broader, comprehensive disclosure framework.

Comments on the RFPI were due June 13, 2021. The RFPI has attracted considerable attention and comments continue to be submitted well past the deadline. Commenters have written to the SEC to address the questions set out in the RFPI as well as a host of related topics. These comments include: structural comments about the SEC's authority and role; technical comments about what might be disclosed and how the SEC might work with standard setters and achieve international harmonization; legal comments about potential securities law liability considerations; comments about external and internal oversight of disclosures; and comments about whether the SEC's forthcoming rulemaking should be limited to public issuers, as opposed to including private issuers, and should be limited to climate, as opposed to including the full suite of ESG topics. In some cases, the comments expressed highly divergent views. For example, some commenters opposed the SEC taking any action at all, while others stated that the need for SEC action is imperative.

**Gabriel D. Rosenberg**, **Margaret E. Tahyar**, **Betty M. Huber**, *and* **Eric B. Lewin** *are attorneys at Davis Polk & Wardwell LLP.* *The authors would like to acknowledge the contribution of firm attorneys Robert A. Cohen and Joseph A. Hall to this article.*

### Background

The RFPI is part of a broader set of recent SEC climate and ESG developments, which are consolidated on the SEC's website. These have included a directive from then-Acting Chair Lee to the Division of Corporation Finance to review and update the SEC's 2010 guidance on climate disclosures,[1] an announcement by the Division of Examination that its 2021 examination priorities would include a greater focus on climate-related risks and the creation of an ESG Task Force in the Division of Enforcement. The RFPI is one important part of a broader SEC climate and ESG agenda, and we expect further developments in the coming months given the SEC's rulemaking agenda and public statements made by Chair Gary Gensler suggesting a continued SEC focus in this area. *(Editor's note: On July 28, 2021, SEC Chair Gensler gave prepared remarks before the Principles for Responsible Investment "Climate and Global Financial*

*Markets" webinair in which he laid out his thoughts on climate change disclosure).* Specifically, according to the SEC's portion of the Spring 2021 Unified Regulatory Agenda, the following ESG and climate items are listed under the Proposed Rule Stage:

- Climate Change Disclosure, Notice of Proposed Rulemaking, by October 2021
- Corporate Board Diversity, Notice of Proposed Rulemaking, by October 2021
- Human Capital Management Disclosure, Notice of Proposed Rulemaking, by October 2021
- Investment Companies and Advisers ESG Matters, Notice of Proposed Rulemaking, by April 2022

As of June 24, 2021, 297 comment letters from institutional commenters filed by the June 13 deadline had been posted by the SEC on its website.[2] Together, these letters amount to 3,290 pages—a vast amount of information for the SEC to consider. In addition, a plethora of unaffiliated individuals submitted comments, and numerous individuals and entities, whose identities were not made available on the SEC's website, submitted four form letter comments that together were submitted over 5,700 times.[3]

## Analysis of Comment Letters

### Commenter Type

Comments were submitted by a wide variety of interested parties, from academics to political figures, individual companies to investors and trade organizations to environmental advocates. The distribution of all institutional non-form comment letters—that is, all letters other than letters from unaffiliated individuals and the over 5,700 form letters—by commenter type is illustrated in Exhibit 1 and Exhibit 2.

**Exhibit 1**

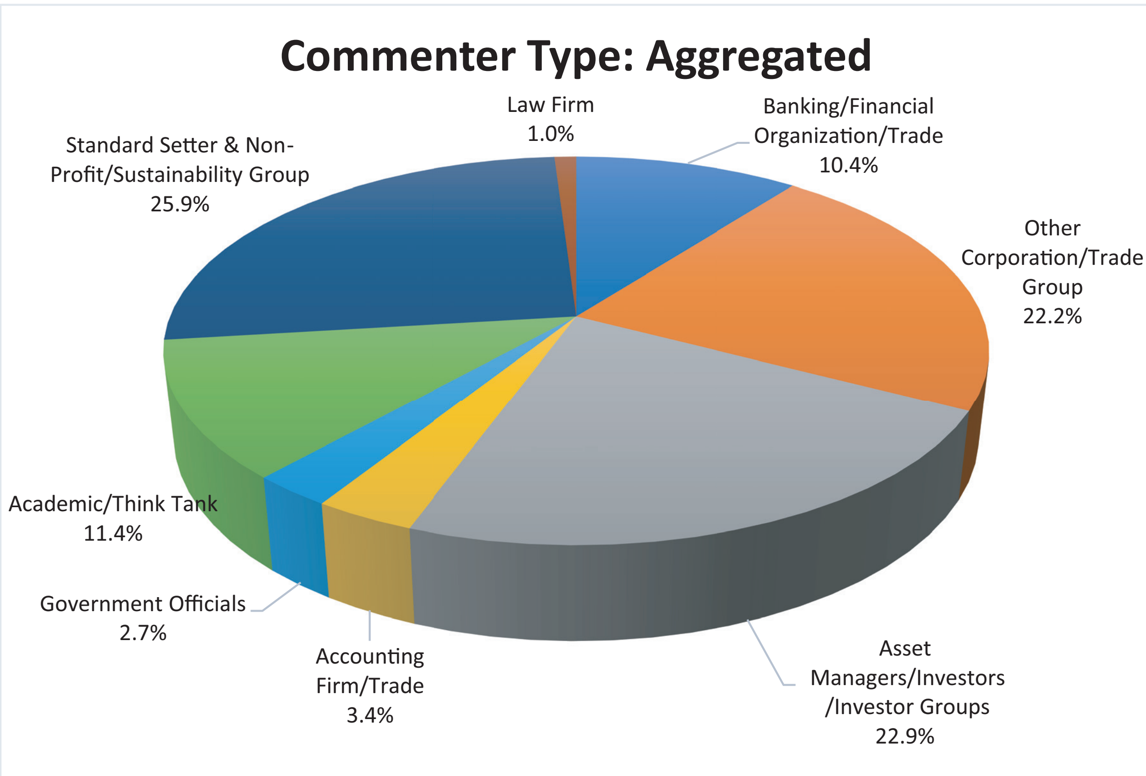


Exhibit 1 presents a high-level breakdown of commenter type, while Exhibit 2 presents the same data at a more granular level.

### Summary of Key Topics Addressed in Comments

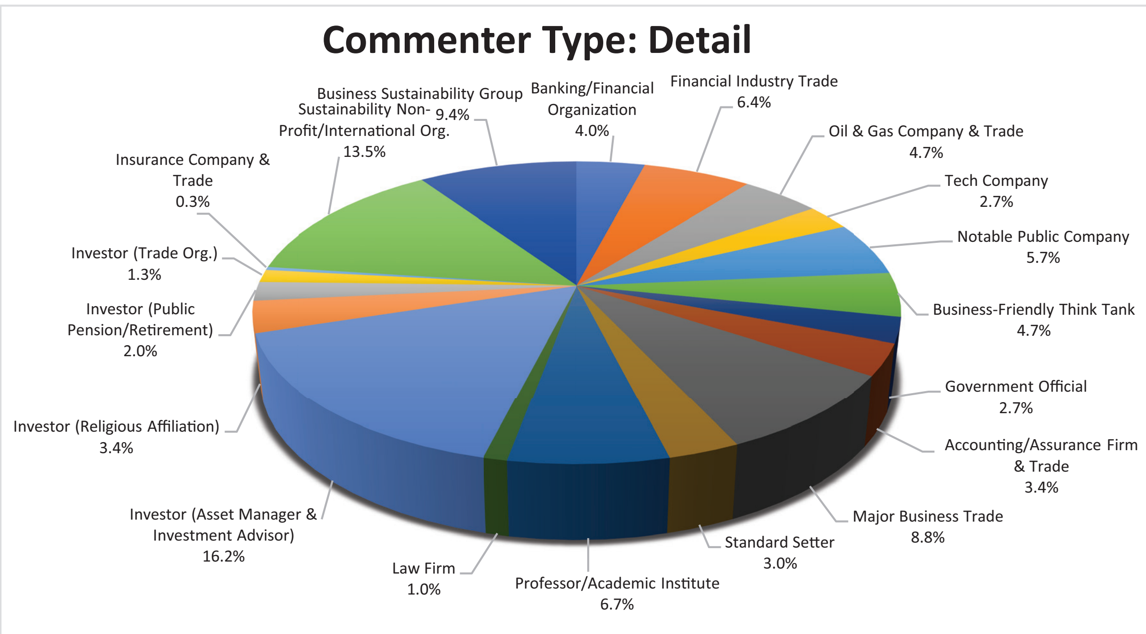
Given the breadth of the issues raised by the comments, we focus on the six questions answered by commenters that we think are the most salient. We discuss each of these areas in additional detail below, along with charts showing the distribution of the positions taken by commenters in these areas. Although the discussions are informed by the RFPI and comments broadly, the charts reflect only the thirty comments that we summarize in detail in an Appendix.[4] For each chart, we present the distribution of these thirty commenters who supported, opposed or gave a mixed response on a particular topic within the six questions outlined above.[5]

#### *1. Does The SEC Have Jurisdiction and Do Benefits Outweigh Costs?*

Some commenters emphasized that even if the SEC wishes to initiate a rulemaking to mandate climate disclosures, they believe that the SEC may not have the authority to do so. In our review of the comments, we observed several forms of this line of reasoning. Some argued that the SEC would need specific statutory authorization to mandate climate disclosures because its current rulemaking authority does not cover the disclosures at issue. Others argued that mandatory climate disclosures would be compelled speech in violation of the First Amendment. Still others highlighted the high compliance costs associated with climate disclosures, particularly for smaller registrants, and either stated or implied that an SEC mandate might not survive the cost-benefit analysis required for SEC rulemaking.[6]

In contrast, other commenters assumed the SEC would have the power to act or have made

**Exhibit 2**



that argument explicitly. Commissioner Lee gave a speech in May 2021 to counter the "myth" that SEC disclosure rulemaking authority is limited to information that is material under the securities laws. Commissioner Lee argued that the SEC has broad rulemaking authority to require disclosures in the public interest, and that this authority is not limited by materiality.[7] (*See* Exhibit 3.)

### *2. Which Standards Should the SEC Adopt?*

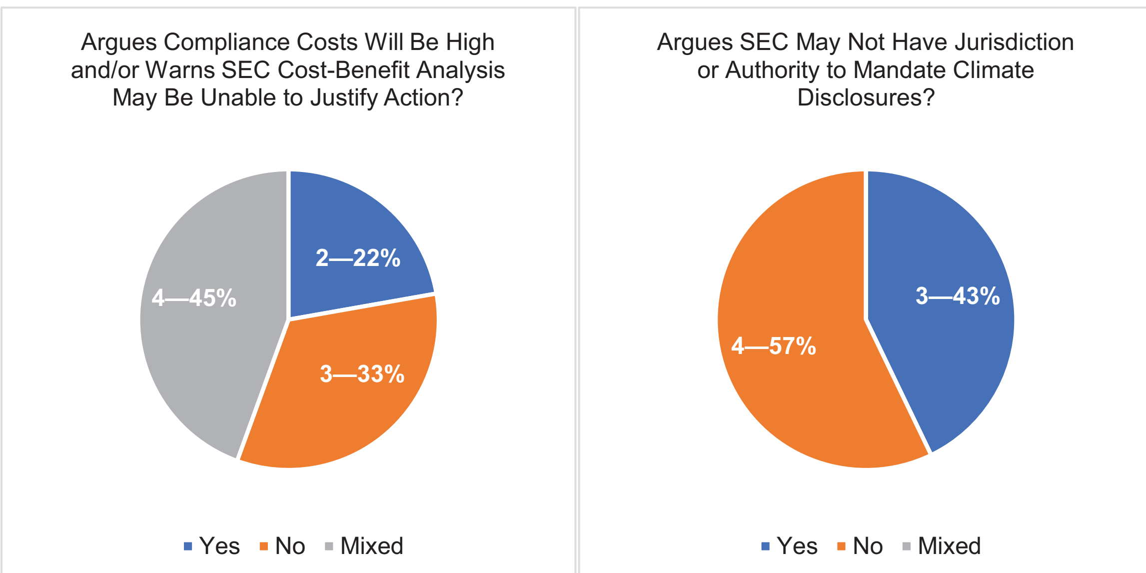
The RFPI raised multiple questions addressing which standards the SEC should use if it were to mandate climate disclosures. These included whether standards should vary by industry, how standards applicable to US registrants should relate to other standards globally and how the SEC's rules should draw upon frameworks already developed by standard-setting bodies.

Industry-specific standards present a potential trade-off between making climate disclosures meaningful and making them comparable. Some commenters expressed a strong desire for industry-specific standards, arguing that the climate aspects of various industries are sufficiently different such that industry-by-industry disclosures are necessary to meaningfully inform investors. Others stressed the importance of universal disclosures that apply to all registrants so that climate risks can be more easily compared across companies.

Aside from whether climate disclosure standards should be industry-specific or universal, commenters also opined on SEC coordination with global climate disclosure efforts. Many commenters encouraged the SEC to contribute to, and work through, international efforts to establish a harmonized global standard. This would promote consistency of disclosures across jurisdictions. Others stressed the need to act quickly or called attention to unique features of the US securities law regime that would merit the SEC establishing its own standards, even if those standards differ from others around the globe.

On the related question of whether the SEC should leverage the work of existing climate standard-setting bodies, including international bodies,

**Exhibit 3—Does the SEC Have Jurisdiction and Do Benefits Outweigh Costs?**



some commenters argued that the SEC should draw upon existing standards—such as those created by the Task Force for Climate-Related Financial Disclosures (TCFD) or the Sustainability Accounting Standards Board (SASB)—for international harmonization, among other reasons. Others argued against doing so, either because of substantive disagreement with those standards, procedural concerns about the governance and funding of those standard setters or both. (*See* Exhibit 4.)

### *3. Qualitative vs. Quantitative Disclosures?*

Beyond questions of whether the SEC should mandate climate disclosures and what standards it should use if it were to impose a disclosure mandate, the RFPI asked whether climate risk information can and should be quantified and disclosed, including, in particular, Scope 3 emissions. Unsurprisingly, commenters took opposing views.

Some commenters maintained that the SEC should require only qualitative climate disclosures, noting the difficulty of quantifying climate data, particularly Scope 3 emissions. These are emissions that "are the result of activities from assets not owned or controlled by the reporting organization, but that the organization indirectly impacts in its value chain,"[8] such as the greenhouse gas emissions attributable to commercial real estate or motor vehicles that a bank finances. Others stressed that it is feasible and appropriate to require quantitative disclosures, which would allow for greater standardization and comparability across companies. These questions are intertwined with the question of whether disclosure standards should be industry specific, discussed above, or whether they should be tiered by company size or market capitalization, as quantification may be less burdensome for companies in certain industries as compared to others. For example, it is arguably easier for a large-cap technology company to measure and disclose accurately its Scope 3 emissions than it is for a small-cap financial institution whose customers are primarily private companies. As noted in their comments, some commenters already voluntarily disclose quantitative climate information, including Scope 3 emissions, which they cite as support the argument that other registrants should be required to do the same. (*See* Exhibit 5.)

**Exhibit 4—Which Standards Should the SEC Adopt?**

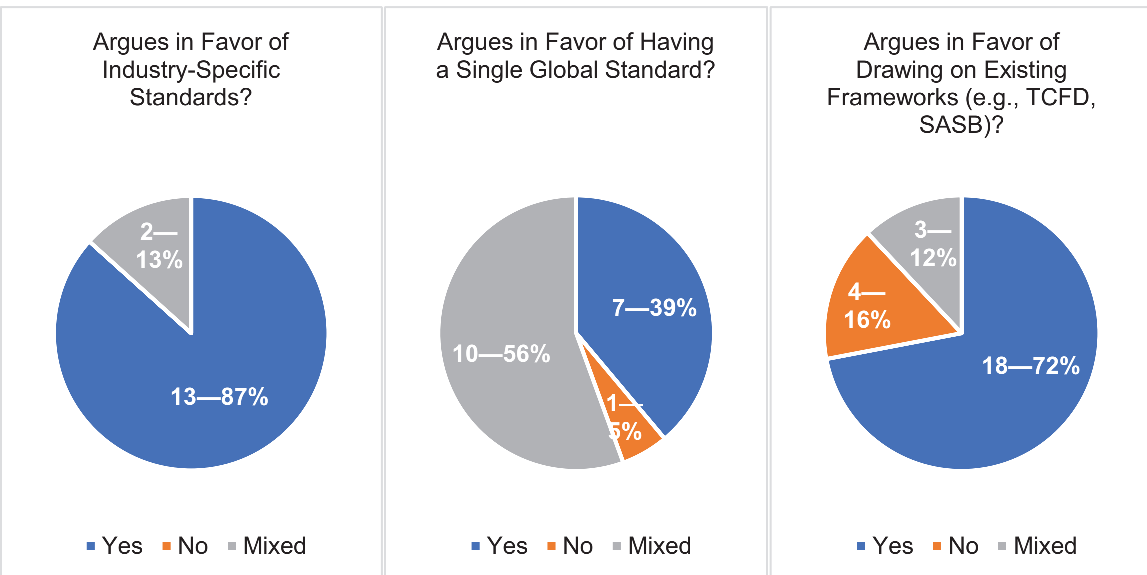
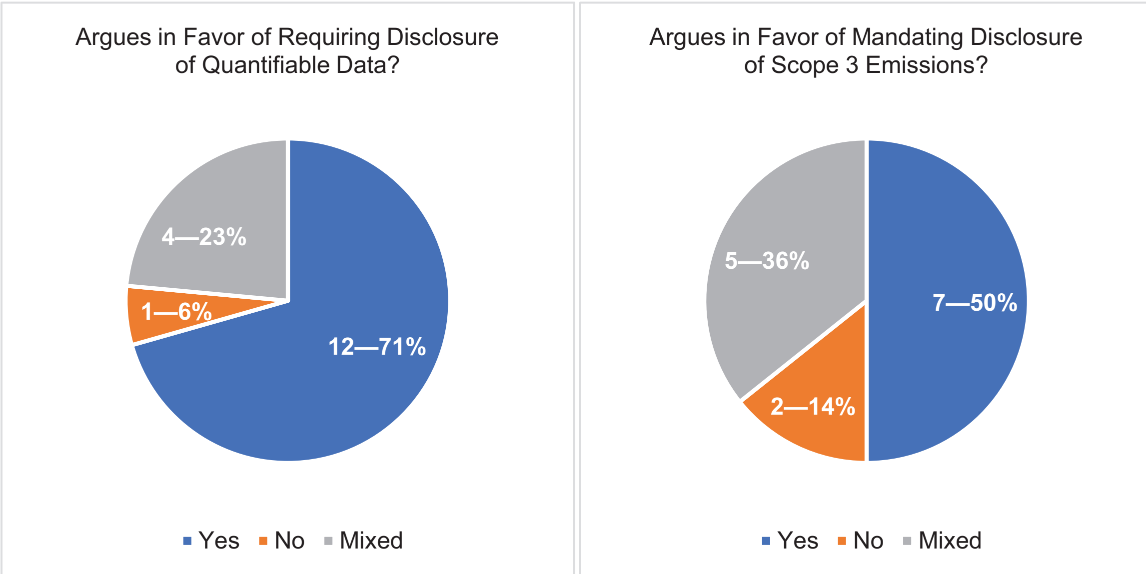


**Exhibit 5—Qualitative vs. Quantitative Disclosures?**




### *4. How Should the SEC Address Potential Liability?*

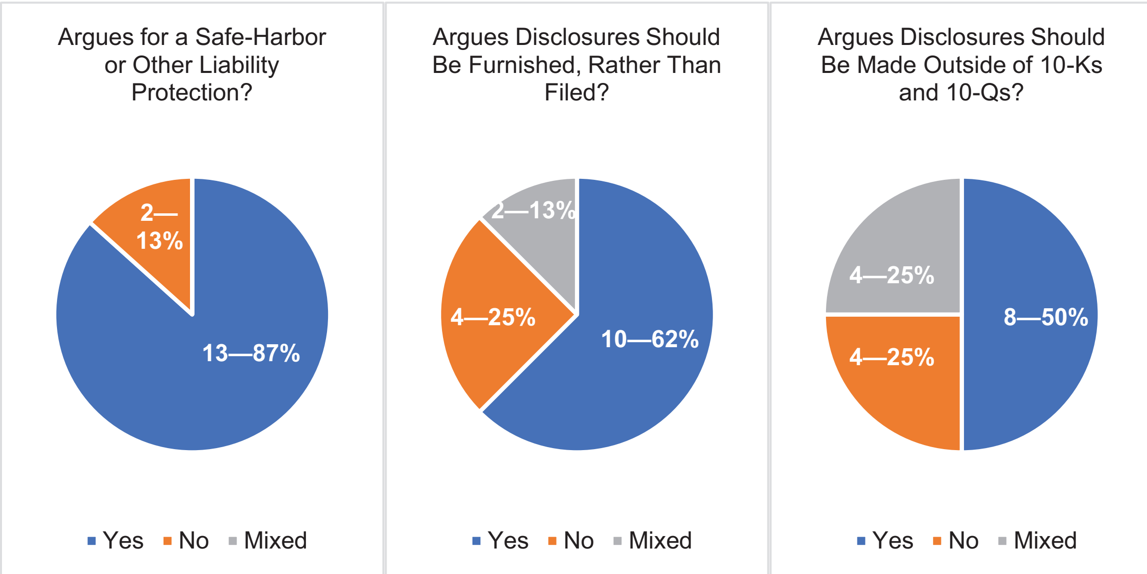
A critical question for issuers is whether and, if so, how the SEC will "address the inevitable litigation risk that will come with such sweeping new disclosure requirements."[9] In the comments on the RFPI, registrants and their trade organizations supported a number of different mechanisms to reduce potential liability. They argued that climate disclosures would present a heightened liability risk given the infancy of climate disclosures and unique features of climate disclosures, such as, for some registrants, necessary reliance on third parties to produce disclosures. Other commenters supported a robust liability regime as a means to enforce climate disclosure requirements and protect investors.

As evidenced by the comments, there are a number of forms that liability for climate disclosures could take. Although not addressed directly in the RFPI, some commenters recommended that the SEC provide a safe harbor from liability for climate disclosures, a position Commissioner Elad L. Roisman has also supported.[10] As part of the question of the form and provenance of liability, several commenters focused on where disclosures would be made and how they would be submitted to the SEC, topics on which the RFPI explicitly solicited comment. Some argued that climate disclosures should be furnished, rather than filed, to limit which securities law liability provisions would apply to the disclosures.[11] Similarly, some argued that disclosures should be provided on a separate, specialized disclosure form outside of 10-Ks and 10-Qs to limit potential application of certain liability provisions in the federal securities laws. (*See* Exhibit 6.)

### *5. Audit or Assurance of Climate Disclosures?*

Several questions in the RFPI relate to measures the SEC might take to promote the reliability of climate disclosures, including measures similar to those used for SEC financial reporting. For example, the RFPI asked whether climate disclosures should be subject to audit or some other form of assurance and, if so, by whom. Another question asked whether management's annual report on internal control over financial reporting should address controls over climate reporting and whether the CEO, CFO or other

**Exhibit 6—How Should the SEC Address Potential Liability?**




corporate officer should be required to certify climate disclosures.

Although some commenters were supportive of auditing or assurance, many others thought they would be a bridge too far.[12] Some of the opposition came from commenters who argued climate disclosures are not yet at the stage where it would be reasonable to apply the same degree of rigor as applicable to financial disclosures. Others appealed to more pragmatic reasons, citing insufficient expertise to conduct climate disclosure audits and explaining that the audit process for climate disclosures is currently so time consuming that disclosures would be stale by the time they were audited. Others—including third-party accounting and audit firms and some international investors—disagreed, highlighting the importance of having an audit or assurance process and explaining that, for some registrants, certain climate disclosures, such as GHG emissions, are already being assured. (*See* Exhibit 7.)

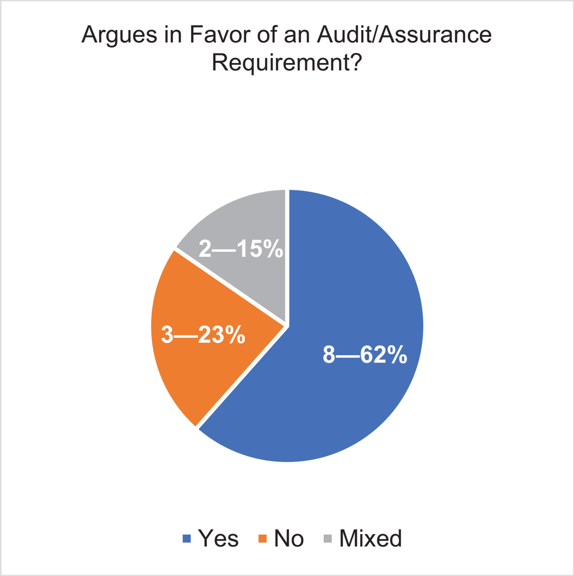
### *6. What Should Be the Scope of Any SEC Action?*

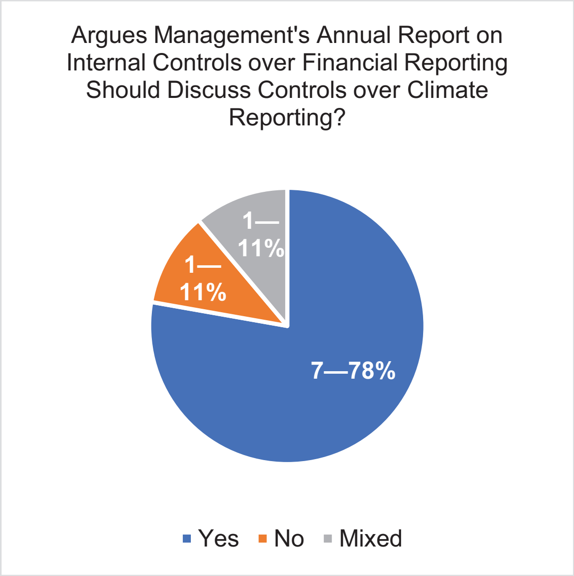
The RFPI raised important questions regarding to whom and over what subject matter any new SEC disclosure requirements might apply. Although much of the RFPI focused on the details of how to implement a climate disclosure regime, these big-picture scoping issues remain open questions.

With respect to scope of covered companies, the RFPI asked whether the SEC should subject private companies to a climate disclosure requirement. Some commenters, such as certain standard setters and investors, supported expanding the requirements to private companies, explaining that investors would benefit from climate disclosures from private companies just as they would from public companies. Some argued that failure to treat public and private companies similarly could result in regulatory arbitrage and could discourage private companies from going public, as well as create a different regulatory regime as compared to the one developing in Europe. In contrast, other commenters argued it would be unnecessary, or even inappropriate, for the SEC to impose a mandate on private issuers, citing reasons including the limited scope of impact of exempt offerings and jurisdictional grounds.

With respect to the scope of subject matter, the RFPI asked whether the SEC should address only

**Exhibit 7—Audit or Assurance of Climate Disclosures?**




climate disclosures at this time or should instead address climate disclosures as part of a broader ESG disclosure framework. Some commenters argued that climate is so important that the SEC should address it first, while acknowledging the importance of ESG matters more broadly. Others opposed mandatory ESG disclosures altogether. Still others supported including climate as part of a broader ESG disclosure package. (*See* Exhibit 8.)

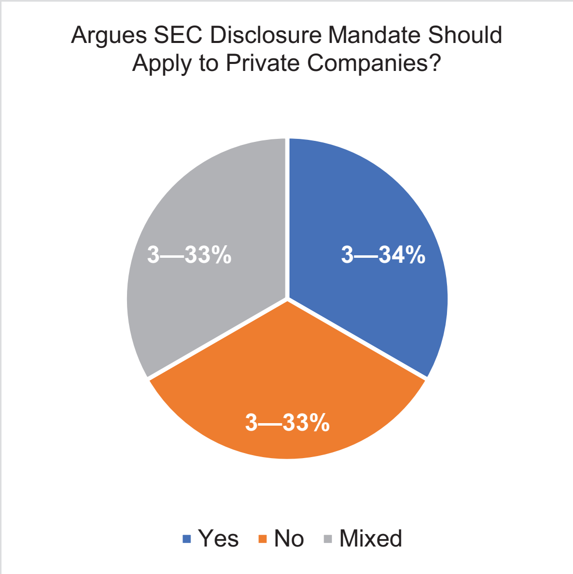
## What's Next?

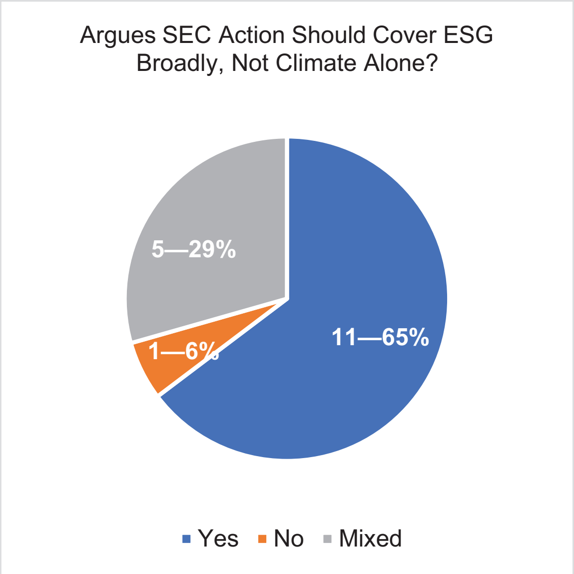
Although the SEC's RFPI was exploratory and not an official proposal, it is widely expected that the SEC will proceed next to a notice of proposed rulemaking with the SEC's initial answers to the questions above. As noted above, in the Spring 2021 Unified Agenda of Regulatory and Deregulatory Action published on June 11, 2021, the SEC included that it intends to issue a notice of proposed rulemaking on climate disclosures in or before October 2021. This intention was crystalized in SEC Chair Gensler's June 23, 2021 speech, in which he noted that he is "really struck by the call for enhanced disclosures" in comment letters responding to the RFPI. He stated that he has asked SEC Staff to develop recommendations on mandatory climate disclosures, including evaluating a range of metrics and considering potential requirements for companies that make forward-looking climate commitments.

Separately, we understand from SEC Staff that they are hard at work evaluating the comments on the RFPI. And although SEC Staff met with dozens of stakeholders regarding the RFPI in the lead-up to the June 13, 2021 submission deadline, since the deadline the SEC Staff have reported only one meeting.

All this points to an upcoming SEC proposal, which, like the RFPI, is sure to solicit a high volume of feedback from key stakeholders with diverse perspectives. Unlike the RFPI, any SEC notice-and-comment rulemaking would be subject to the requirements of the Administrative Procedure Act,[13] and the SEC would be required to respond in a final rule to "materially cogent" comments.[14] The rulemaking process therefore would give the public a second bite at the apple beyond the RFPI, and one the SEC would have to address head on.

**Exhibit 8—What Should Be the Scope of Any SEC Action?**




On the international front, global bodies focused on climate disclosures also continue to forge ahead. For example, on June 28, the board of the International Organizations of Securities Commissions (IOSCO) issued a report on sustainability-related issuer disclosures. The report, developed by IOSCO's Sustainability Finance Taskforce, highlights the need to enhance consistency, comparability and reliability of sustainability reporting for investors, citing the recent June 5 G7 Finance Ministers and Central Bank Governors Communiqué to a similar effect. IOSCO's report is supportive of the work of the International Financial Reporting Standards Foundation (IFRS Foundation) to establish an International Sustainability Standards Board (ISSB) for developing a climate reporting standard. The report notes that IOSCO has established a Technical Expert Group—which is co-led by the SEC—to engage with the IFRS Foundation on the ISSB, and calls for creating standards leveraging the work of existing frameworks, including those of TCFD, the Global Reporting Initiative and SASB, among others.

## Notes

1. *See* SEC, Commission Guidance Regarding Disclosures Related to Climate Change, 75 Fed. Reg. 6290 (Feb. 8, 2010).
2. Comment letters are typically uploaded to the SEC's website with a lag. We use the SEC's June 13 comment deadline as a cutoff for the letters in scope for our analysis, but it is possible additional letters submitted prior to the deadline were uploaded subsequent to preparation of this client update. In addition, some comments were submitted subsequent to the June 13 deadline, and the SEC has been uploading these comments to its website, but these letters are not included in our analysis. As discussed further below, we also exclude from our analysis form letter comments that may have been submitted by either institutions or individuals.
3. An Appendix summarizing the recommendations made in 30 institutional comments is available at *https://www.davispolk.com/insights/client-update/commenters-weigh-sec-climate-disclosures-request-public-input*.
4. *See id.* for the availability of the Appendix.
5. For any particular topic, commenters are excluded from the chart if they did not address the issue. We recorded a

response as "mixed" if a commenter both discussed the topic and either provided some support and some opposition for the topic or did not provide a clear directional view.

6. *See* 15 U.S.C. §§ 77b(b), 78c(f) (requiring, as part of any rulemaking under the Securities Act of 1933 and Securities Exchange Act of 1934, respectively, in which the SEC "is required to consider or determine whether an action is necessary or appropriate in the public interest," that the SEC "also consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation"); *see also, e.g.*, *Business Roundtable v. SEC*, 647 F.3d 1144, 1148–49 (D.C. Cir. 2011) (vacating the SEC's proxy access rule for failure to "adequately assess the economic effects of a new rule," as required by Section 3(f) of the Securities Exchange Act of 1934 and Section 2(c) of the Investment Company Act of 1940, 15 U.S.C. §§ 78c(f), 80a-2(c), by, among other things "inconsistently and opportunistically fram[ing] the costs and benefits of the rule" and "fail[ing] to adequately quantify the certain costs or to explain why those costs could not be quantified").
7. For this proposition, Commissioner Lee cited to the SEC's rulemaking authority under the Securities Act of 1933 and the Securities Exchange Act of 1934, 15 U.S.C. §§ 77g(a)(1), 78m(a), 78l(b), and 78o(d).
8. U.S. Environmental Protection Agency (EPA), EPA Center for Corporate Climate Leadership, Scope 3 Inventory Guidance (May 18, 2021), available at *https://www.epa.gov/climateleadership/scope-3-inventory-guidance*. The EPA explains that Scope 3 emissions are often the majority of an organization's greenhouse gas emissions, and the EPA distinguishes these from Scope 1 and Scope 2 emissions. *See id.* As defined by the EPA, "Scope 1 emissions are direct greenhouse (GHG) emissions that occur from sources that are controlled or owned by an organization (e.g., emissions associated with fuel combustion in boilers, furnaces, vehicles)," and "Scope 2 emissions are indirect GHG emissions associated with the purchase of electricity, steam, heat, or cooling." EPA, EPA Center for Corporate Climate Leadership, Scope 1 and 2 Inventory Guidance (Dec. 14, 2020), available at *https://www.epa.gov/climateleadership/scope-1-and-scope-2-inventory-guidance*.
9. Commissioner Elad L. Roisman, Putting the Electric Cart before the Horse: Addressing Inevitable Costs of a New ESG Disclosure Regime (June 3, 2021), available at *https://www.sec.gov/news/speech/roisman-esg-2021-06-03*.
10. *See id.*
11. The difference may appear to be one of semantics, but it is far from that. Unlike filings with the SEC, furnished reports are not subject to potential liability under Section 18 of the Securities Exchange Act of 1934. *See* 15 U.S.C. § 78r. Moreover, certain standard filings, such as 10-Ks and 10-Qs, are routinely incorporated by reference in the securities offering documents of issuers, to which potential liability attaches under several provisions—including some strict liability provisions—of the Securities Act of 1933.
12. This observation relates to the institutional comments at large, as our set of thirty comments discussed in detail in the Appendix—which includes several audit firms—may not be representative with respect to this question.
13. *See* 5 U.S.C. § 553.
14. *See, e.g.*, United States v. Nova Scotia Food Products Corp., 568 F.2d 240, 252 (2d Cir. 1977) ("Appellants additionally attack the 'concise general statement' required by APA, 5 U.S.C. § 553, as inadequate. We think that, in the circumstances, it was less than adequate. It is not in keeping with the rational process to leave vital questions, raised by comments which are of cogent materiality, completely unanswered. The agencies certainly have a good deal of discretion in expressing the basis of a rule, but the agencies do not have quite the prerogative of obscurantism reserved to legislatures.").

# IN THE COURTS

## Supreme Court Remands Securities Class Action Against Goldman Sachs Back to Second Circuit

*By Paul J. Walsen, Amy J. Eldridge, Nicole C. Mueller, and Michael W. Fakhoury*

On 21 June 2021, in a narrow ruling, the Supreme Court held that courts may consider the generic nature of an alleged misrepresentation as evidence of a lack of price impact where defendants seek to rebut the presumption of reliance—established under *Basic Inc. v. Levinson*[1]—at the class certification stage.[2] A court must consider this evidence even though it also may bear on the materiality of a statement, an issue which is reserved for the merits phase of the action.

The Supreme Court also clarified the burden that defendants must discharge in order to rebut the *Basic* presumption at class certification: Defendants bear the burden of persuasion to show a lack of price impact by a preponderance of the evidence.

On balance, the decision favors securities defendants seeking to defeat class certification. In cases where there is a mismatch between the generality of the misrepresentation and the specificity of the corrective disclosure,

> it is less likely that the specific disclosure actually corrected the generic misrepresentation, which means that there is less reason to infer front-end price inflation, that is, price impact, from the back-end price drop.[3]

**Paul J. Walsen, Amy J. Eldridge, Nicole C. Mueller,** *and* **Michael W. Fakhoury** *are attorneys at K&L Gates LLP.*

### Background and the *Basic* Presumption

The case arises from a putative securities class action in the US District Court for the Southern District of New York under Section 10(b) and Rule 10b-5 of the Securities Exchange Act of 1934.[4] Plaintiff shareholders alleged that Goldman Sachs Group, Inc. (Goldman) and three of its former executives committed securities fraud by making misrepresentations that caused Goldman's stock price to remain inflated by preventing preexisting inflation from dissipating from the stock price.[5] In particular,

> Plaintiffs allege[d] that between 2006 and 2010, Goldman maintained an inflated stock price by making repeated misrepresentations about its conflict-of-interest policies and business practices.[6]

The alleged misstatements included generic statements about Goldman's ability to manage conflicts, for example, "[w]e have extensive procedures and controls that are designed to identify and address conflicts of interest"; "[o]ur clients' interests always come first"; and "[i]ntegrity and honesty are at the heart of our business."[7] Plaintiffs alleged that these generic statements were false or misleading in light of several undisclosed conflicts of interest, and Goldman's stock price dropped and shareholders suffered losses once the supposed truth about Goldman's conflicts was revealed.[8]

Plaintiffs sought to certify a class of Goldman shareholders by invoking the presumption endorsed by the Supreme Court in *Basic*.[9] The *Basic* presumption is premised on the theory that investors rely on the market price of a company's security, which in an efficient market incorporates all of the company's public misrepresentations. To invoke the presumption, a plaintiff must prove that (1) the alleged misrepresentation was publicly known, (2) it was material, (3) the stock traded in an efficient market, and (4) the plaintiff traded the stock between the time the misrepresentation was made and when the truth was revealed.[10] A class action plaintiff must prove the *Basic* prerequisites before class certification, with one exception: The Supreme Court previously determined that materiality should be left to the merits phase because it does not bear on the question considered at class certification, namely, whether common questions predominate.[11] In this case, plaintiffs posited that Goldman shareholders relied on the "inflation maintenance" or "price maintenance" theory, in which the defendants' generic purported misstatements regarding Goldman's conflicts processes artificially maintained an already inflated stock price.

The *Basic* presumption, however, can be rebutted. In *Halliburton*, the Supreme Court held that a defendant can overcome the *Basic* presumption at the class certification stage by showing "that an alleged misrepresentation did not actually affect the market price of the stock."[12] If a misrepresentation had no price impact, then *Basic*'s fundamental premise "completely collapses, rendering class certification inappropriate."[13] Defendants sought to rebut the *Basic* presumption and defeat class certification through evidence that the alleged misrepresentations were too general to have any impact on Goldman's stock price.[14]

The district court certified the class, a decision that was initially vacated by the Second Circuit on the ground that defendants bear the burden of persuasion to prove a lack of price impact by a preponderance of the evidence, and the district court had erred by holding defendants to a higher burden of proof and by refusing to consider some of its price-impact evidence.[15] Following remand of the case, the district court certified the class again under the standard set forth by the Second Circuit. The Second Circuit subsequently affirmed the decision in a divided opinion, holding that considering the generic nature of a statement at the class certification stage was inappropriate because it spoke to a statement's materiality and is unrelated to the issue of whether common questions predominate over individual issues.[16] However, in a dissent, Judge Sullivan noted his colleagues "miss[ed] the forests for the trees" [17] and "the majority tiptoe[d] around the fact" [18] that no reasonable investor would have attached any significance to the generic nature of defendants' statements.[19]

Defendants sought review by the Supreme Court, arguing that the Second Circuit erred in two ways: first, by holding that the generic nature of the alleged misrepresentations is irrelevant to the price-impact inquiry; and second, by assigning Defendants the burden of persuasion—rather than the lesser burden of production—to prove a lack of price impact.[20]

## The Supreme Court's Decision

Justice Amy Coney Barrett delivered the opinion of the Supreme Court on 21 June 2021, which was joined in full by Chief Justice John Roberts and Justices Stephen Breyer, Elena Kagan, and Brett Kavanaugh. Justices Clarence Thomas, Samuel Alito, Neil Gorsuch, and Sonia Sotomayor joined in part. Justice Sotomayor also filed an opinion concurring in part and dissenting in part, and Justice Gorsuch filed an opinion concurring in part and dissenting in part, in which Justices Thomas and Alito joined.

The Supreme Court held that "*all* probative evidence" in assessing price impact at class certification should be considered, "regardless [of] whether the evidence is also relevant to a merits question like materiality."[21] The Supreme Court noted that

> [t]he generic nature of a misrepresentation often will be important evidence of a lack of price impact, particularly in cases proceeding under the inflation-maintenance theory.[22]

The Supreme Court remanded the matter back to the Second Circuit because it concluded that the Second Circuit's opinion left sufficient doubt as to whether it had properly considered the generic nature of the alleged misrepresentations.

In addressing the burden that defendants must carry in order to rebut the *Basic* presumption, the Supreme Court provided additional clarity: Defendants bear the burden of persuasion to prove a lack of price impact by a preponderance of the evidence at class certification.[23] In short, a defendant must do more than meet the burden of production by offering some evidence relevant to price impact; the defendant must carry the burden of persuasion by "sever[ing] the link between the alleged misrepresentation and . . . the price received (or paid)" by the plaintiff.[24] The Supreme Court observed that to hold otherwise—and allow the burden to shift back to plaintiffs upon the mustering of any competent evidence regarding lack of price impact (such as the generic nature of the alleged misrepresentations) would negate "in almost every case" the Supreme Court's prior holdings that plaintiffs need not directly prove price impact to invoke the *Basic* presumption.[25]

## Takeaways

*Goldman* provides a tempered victory for defendants seeking to defeat class certification, particularly in price maintenance cases. In cases where there is a mismatch between the generality of the misrepresentation and the specificity of the corrective disclosure, a door has been opened for defendants to present arguments previously unlikely to gain traction at the class certification stage of the proceedings.

### Notes

1. Basic Inc. v. Levinson, 485 U.S. 224 (1988).
2. Goldman Sachs Grp., Inc., v. Ark. Tchr. Ret. Sys., No. 20-222, 2, slip op. (US June 21, 2021).
3. *Goldman*, slip op. at 8.
4. *Id.* at 4.
5. *Id.*
6. *Id.* at 5.
7. *Id.*
8. *Id.* at 1.
9. *Id.*
10. Halliburton Co. v. Erica P. John Fund, Inc., 573 U.S. 258, 267 (2014); *see generally* Roberta Anderson et al., "Halliburton II: Supreme Court Upholds Fraud on the Market Presumption, but Gives Securities Defendants a Fighting Chance at Defeating Class Certification," *JD Supra* (July 8, 2014), *https://www.jdsupra.com/legalnews/halliburton-ii-supreme-court-upholds-fr-21614/*.
11. *Goldman*, slip op. at 4.
12. *Id.* (quoting *Halliburton*, 573 U.S. at 284).
13. *Id.*
14. *Id.* at 1–2.
15. Ark. Tchrs. Ret. Sys. v. Goldman Grp., Inc., 879 F.3d 474 (2d Cir. 2018).
16. Ark. Tchrs. Ret. Sys. v. Goldman Grp. Inc., 955 F.3d 254 (2d Cir. 2020).
17. *Id.* at 275 (Sullivan, J., dissenting).
18. *Id.* at 278 (Sullivan, J., dissenting).
19. *Id.*
20. *Goldman*, slip op. at 2, 6.
21. *Id.* at 7 (emphasis in original).
22. *Id.* at 8.
23. *Id.* at 10.
24. *Id.* (quoting *Halliburton*, 573 U.S. at 279).
25. *Id.* at 11.

# CLIENT MEMOS

*A summary of recent memoranda that law firms have provided to their clients and other interested persons concerning legal developments. Firms are invited to submit their memoranda to the editor. Persons wishing to obtain copies of the listed memoranda should contact the firms directly.*

## Akin, Gump, Strauss, Hauer & Feld LLP
## Washington, DC (202-887-4000)

### Qualified Client Thresholds Increased (July 6, 2021)

A discussion of the actions required by private fund managers to address the SEC's new "qualified client" assets under management and net worth thresholds applicable to private funds relying on the Section 3(c)(1) exemption under the Investment Company Act of 1940.

## Arnold & Porter Kaye Scholer LLP
## Washington, DC (202-942-5000)

### ESG Disclosures for Financial Institutions (July 16, 2021)

A discussion SEC statements and steps during 2021 indicating that it likely will soon enhance its climate-related disclosure requirements for all public companies, including financial institutions.

## Covington & Burling LLP
## Washington, DC (202-662-6000)

### Key Takeaways from NYSE and Nasdaq on ESG (July 8, 2021)

A discussion of the New York Stock Exchange (NYSE) report on "Best Practices for Sustainability Reporting" and the Nasdaq Stock Market LLC (Nasdaq) overview of approaches companies may consider to engage effectively with their stakeholders on ESG issues.

## Davis Polk & Wardwell LLP
## New York, NY (212-450-4000)

### SEC Charges SPAC, Sponsor, Target and CEOs for Misleading Disclosures and Inadequate Due Diligence (July 15, 2021)

A discussion of a SEC enforcement action relating to a planned merger of a company, a special purpose acquisition company (SPAC) and the proposed merger target. The SEC charged the target and its former CEO with making misrepresentations, and also charged the SPAC, its CEO and the sponsor with due diligence failures.

## Dorsey & Whitney LLP
## Minneapolis, MN (612-340-2600)

### 2021 Delaware Entity Statutory Amendments (July 6, 2021)

A discussion of the 2021 amendments to the Delaware entity statutes (the Delaware General Corporation Law, the Delaware Limited Liability Company Act, the Delaware Revised Uniform Limited Partnership Act and the Delaware Revised Uniform Partnership Act) signed into law by the Governor of Delaware.

## Fenwick & West LLP
## Mountainview, CA (650-988-8500)

### Public Company Guide—Planning for Shareholder Engagement (July 26, 2021)

A guide focusing on direct engagement between a company and institutional shareholders outside of a contested election.

## Jones Day LLP
## Cleveland, OH (216-586-3939)

### Recent SEC Enforcement Action Stresses Importance of Not Impeding Whistleblower Communications with Regulators (July 2021)

A discussion of a SEC enforcement case critical of a registered broker-dealer for potentially attempting to impede an individual from communicating with the agency in violation of Rule 21F-17 under the Securities Exchange Act of 1934 (Exchange Act).

## Katten Muchin Rosenman LLP
## Chicago, IL (312-902-5200)

### FINRA Clarifies Guidance on Best Execution and Payment for Order Flow (July 28, 2021)

A discussion of a FINRA regulatory notice reminding firms of their obligations with respect to best execution and payment for order flow.

## Mayer Brown LLP
## Chicago, IL (312-782-0600)

### IOSCO Ratchets Up Pressure on ESG Disclosure for Companies and Asset Managers (July 2, 2021)

A discussion of two reports issued by the International Organization of Securities Commissions (IOSCO) drawing further attention to ESG-related disclosures by issuers and asset managers.

## Paul, Weiss, Rifkind, Wharton & Garrison LLP
## New York, NY (212-373-3000)

### Delaware Court of Chancery Finds No MAE (July 15, 2021)

A discussion of a Delaware Court of Chancery decision, *Bardy Diagnostics, Inc. v. Hill-Rom, Inc.*, holding that a dramatic 50+ percent reduction in the Medicare reimbursement rate for a target's sole product did not constitute a "Material Adverse Effect" (MAE) under a merger agreement.

## Perkins Coie LLP
## Seattle, WA (206-359-8000)

### Sustainability Disclosures: What Is Material? (July 13, 2021)

A discussion of the debate over the materiality of ESG disclosures to investors and suggested action items for companies considering increased disclosure on these topics.

## Reed Smith LLP
## New York, NY (212-521-5400)

### Delaware Court of Chancery Holds that Stockholders Who Became Stockholders through an IPO Lack Derivative Standing (July 2021)

A discussion of a Delaware Court of Chancery decision, *In re SmileDirectClub, Inc.*, declining to extend any exceptions to the "contemporaneous ownership rule" to plaintiff stockholders who became stockholders through the transaction they sought to challenge.

### Be Careful What You Ask For (July 2021)

A discussion of a Delaware Court of Chancery decision, *The Raj and Sonal Abhyanker Family Trust v. Blake*, highlighting how a stockholder of a Delaware corporation can materially prejudice their derivative claims against the corporation's board of directors if the stockholder "demands" the board take remedial actions in connection with the stockholder's claims.

## Sidley Austin LLP
## Chicago, IL (312-853-7000)

### "How to Be ESG" (July 8, 2021)

A discussion of how directors of mutual funds and exchange-traded funds that focus on ESG investing can prepare for the increased regulatory scrutiny by the SEC.

#### FINRA Announces Impending Special Purpose Acquisition Company Sweep (July 26, 2021)

A discussion of an announcement by FINRA that the self-regulatory organization plans to conduct a series of targeted reviews into special purpose acquisition companies.

### Simpson, Thacher & Bartlett LLP New York, NY (212-455-2000)

#### SEC's Spring 2021 Regulatory Agenda (July 19, 2021)

A discussion of the SEC's Spring 2021 Unified Agenda of Regulatory and Deregulatory Actions, which provides a preview of the SEC's proposals for short- and long-term regulatory actions and rulemakings.

### Skadden, Arps, Slate, Meagher & Flom LLP New York, NY (212-735-3000)

#### Supreme Court Grants Review of Scope of PSLRA Stay (July 2, 2021)

A discussion of the US Supreme Court's grant of *certiorari* in *Pivotal Software v. Tran*, a case involving the issue of whether the stay provision in the Private Securities Litigation Reform Act of 1995 applies to Securities Act of 1933 cases brought in state court, and not just those in federal court.

### Sullivan & Cromwell LLP New York, NY (212-588-4000)

#### Delaware Court of Chancery Holds 35.3 Percent Stockholder Was Not a Controller (June 21, 2021)

A discussion of a Delaware Court of Chancery decision, *In re GGP, Inc. Stockholder Litigation*, holding that plaintiffs failed to plead minority control.

### Troutman Pepper Hamilton Sanders LLP Atlanta, GA (404-885-3000)

#### Recent Developments in Auditing Could Create Tensions (July 2, 2021)

A discussion of the need for public companies to prepare for a more strenuous auditing process and the increased likelihood that the information they share with their auditors could be compelled by the SEC during an investigation.

#### Companies Should Exercise Caution When Addressing Anonymous Whistleblower Complaints (July 13, 2021)

A discuss of the need for public companies to proceed with caution when receiving and investigating anonymous whistleblower complaints.

### Wilmer Cutler Pickering Hale and Door Washington, DC (202-663-6000)

#### Split SEC Settles Touting Charge with ICO "Listing" Website (July 28, 2021)

A discussion of a SEC settled enforcement action against the UK operator of a now-defunct website that profiled offerings of digital securities. Two SEC commissioner dissented on the basis that the SEC's order failed to cite which digital assets listed on the site were securities.

# INSIDE THE SEC

## The SEC's Record-Breaking Whistleblower Award Run: Practical Considerations for Companies

*By Jane Norberg, Daniel M. Hawke, Veronica E. Callahan, and Michael D. Trager*

After fiscal year (FY) 2020, when the Office of the Whistleblower (OWB) of the Securities and Exchange Commission (SEC or Commission) awarded a record-breaking $175 million to 39 individuals, FY 2021 has proven to be even more active. As of mid-June 2021, with more than three months still left in FY 2021, the Commission already had awarded approximately $370 million to whistleblowers, setting up the year to surpass FY 2020 for an all-time high. Notably, in just over a month earlier this year, the Commission awarded approximately $116 million in awards in nine SEC enforcement actions and two related actions brought by other agencies.

### Background

Formed in 2011, the OWB was established one year after the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank) amended the Securities Exchange Act of 1934 (Exchange Act) by, among other things, adopting Section 21F.[1] This Section, entitled "Securities Whistleblower Incentives and Protection," directs the Commission to make monetary awards to eligible individuals who voluntarily provide original information that leads to successful SEC enforcement actions resulting in monetary sanctions over $1 million, and successful related actions. Awards may range between 10 percent and 30 percent of the money collected. In addition to providing monetary awards to certain whistleblowers, Dodd-Frank and the Commission's implementing rules create confidentiality protections for whistleblower submissions and prohibit employers from retaliating against whistleblowers for providing information to the SEC.[2]

The Commission has relatively straightforward procedures for claiming a whistleblower award. Following a successful "Covered Action," which is defined as any judicial or administrative action brought by the Commission under the securities laws that results in monetary sanctions exceeding $1 million, the OWB will post a "Notice of Covered Action" on the OWB website.[3] Within 90 calendar days of the Notice of Covered Action, a whistleblower must submit a claim in order to collect an award,[4] and there are additional procedures for whistleblowers seeking to receive an award based on monetary sanctions collected from a "Related Action" brought by certain other agencies or regulators.[5] OWB attorneys assess each claim and the eligibility of the claimant, including conferring with relevant investigative or other SEC Staff. OWB attorneys then provide a recommendation to "Claims Review Staff" comprised of senior leaders in the Division of Enforcement and, in the case of a positive award recommendation or a contested denial, to the Commission. After consideration, the Commission issues Final Orders determining whistleblower award claims. These orders are usually heavily redacted, such that the name of the whistleblower and the Covered or Related Actions are not publicly disclosed.

**Jane Norberg**, **Daniel M. Hawke**, **Veronica E. Callahan**, *and* **Michael D. Trager** *are attorneys at Arnold & Porter Kaye Scholer LLP. Firm attorneys Sasha Zheng, Stephanna F. Szotkowski, and Joshua R. Martin also contributed to this column.*

## Recent Awards and a Notable Trend

The OWB's activity in the first half of 2021 continued the uptick in awards seen in 2020. In May 2021 and halfway through June 2021 alone, the Commission issued awards to 19 individuals, totaling approximately $116 million. The SEC also is taking a liberal stance when it comes to interpreting provisions of the federal securities laws in a manner that appears to be designed to encourage whistleblowers to come forward.

In a recent Final Order issued on June 2, 2021, the Commission awarded approximately $23 million to two whistleblowers whose information and assistance led to successful SEC and related actions.[6] One of the whistleblowers filed the application for award 18 days after the 90-day deadline, normally a fatal procedural defect. In the Final Order, the Commission noted that the mitigating circumstances asserted by the claimant did not rise to the level of circumstances beyond the claimant's control and, therefore, were not "extraordinary circumstances" that might otherwise allow the Commission to waive the deadline under Rule 21F-8(a) of the Exchange Act. Despite this, the Commission determined to exercise its discretionary authority under Section 36(a) of the Exchange Act to waive the procedural defect and grant the whistleblower award. In doing so, the Commission noted that, based on the specific facts and circumstances of this case,

> [s]trict application of the deadline would result in undue hardship to [the claimant], particularly in light of [the claimant's] significant contributions to the successful enforcement of the Covered Action and certain unique obstacles faced by [the claimant].

Given that the waiver of this deadline has been denied in the past, this rare use of Section 36(a) exemptive authority to waive the application filing deadline shows the value that the current Commission places on otherwise meritorious whistleblower tips.[7]

The Commission also showed a willingness to interpret Dodd-Frank and the SEC's implementing rules liberally to grant awards to whistleblowers in another high-value Final Order awarded on May 19, 2021.[8] In the Final Order, the Commission awarded $28 million for a tip with a more tenuous nexus to the Covered Action—the whistleblower reported wrongdoing in one geographic region that resulted in investigations by the SEC and another agency, but the ultimate charges were based on conduct in another geographic region *not* reported by the whistleblower. The Final Order noted that, although "the Covered Action's and the Related Action's charges involved misconduct in geographical regions that were not the subject of the Claimant's information" and there was "not a strong nexus between the Claimant's information and the . . . charges," an award would nonetheless be granted that "appropriately recognizes Claimant's level of contribution to the Covered Action and Related Action." This award was one of the ten largest awards ever paid out by the Commission.[9]

Of note, unlike the usual anonymous nature of whistleblower tips, purported counsel for the whistleblower in the May 19 Final Order has given public statements to news media.[10] In these statements, counsel has claimed that the award was for information resulting in the 2018 settlements of Foreign Corrupt Practices Act (FCPA) charges against Panasonic Avionics Corporation (PAC), which makes entertainment and communications systems for aircraft, along with certain of its former executives. PAC ultimately paid more than $137 million to the DOJ, and its parent company paid more than $143 million to the SEC, in connection with these FCPA and related charges.[11] If true, the public statements made by the whistleblower's counsel provide a rare public view into what is usually a confidential process.

## Implications and Some Practical Considerations

In FY 2020, the Commission received more than 6,900 whistleblower tips, a 31 percent increase from FY 2018, the second-highest tip year.[12] The high number of tips, the high value of awards, and the willingness of the SEC to liberally interpret the rules all indicate that the Commission views whistleblower tips as an important source of information in assessing wrongdoing in the markets. Credible whistleblower tips may serve as an increasing impetus to the opening of investigations by both the SEC and other regulators—and, given the start to FY 2021, the trend is likely to continue (if not strengthen) under the new administration.

In light of this, companies would be well-advised to anticipate the possibility of increased whistleblower activity and take proactive measures to ensure they comply with applicable law. While every situation is different, there are some practical considerations to bear in mind.

### Risk Assessments

Consider conducting risk assessments related to internal reporting structures to make sure that all reports—not just those going to an internal hotline—are captured, triaged, and investigated if appropriate. Use internal whistleblower information to get ahead of a potential problem with the regulators or law enforcement. Companies that are able to conduct thorough internal investigations showing a clear, robust response to an internal tip will be better able to effectively self-correct and have a defensible position if regulators or law enforcement get involved.

### Annual Training

Consider if annual training is appropriately robust and targeted to middle management to ensure that tips received outside of the employee hotline or formal reporting mechanisms are identified, logged, and triaged. This is particularly important given that 81 percent of SEC whistleblower awardees reported their concerns internally, including in many instances to their direct supervisor, before or at the same time as reporting to the Commission. If all tips are not identified and centrally reviewed, it is a lost opportunity for a company to self-correct an issue.

### Internal Reporting Mechanisms in a Post-Covid World

As more companies are pivoting back to an in-person workforce, consider a refresh on internal reporting mechanisms as well as related training. Record-breaking numbers of tips were reported to the SEC during the pandemic. This may have been because of a breakdown in internal reporting mechanisms for a remote workforce. Consider a fresh internal reporting campaign to refocus a returning workforce, whether it be full-time in the office, continuing remote, or some hybrid. The statistics show that the current mechanisms for internal reporting may not be effective anymore.

### Anti-Retaliation Policies and Training

Ensure that whistleblower anti-retaliation polices and training are up-to-date. Now is the time for companies to review anti-retaliation policies to ensure they are clear and concise. Annual training should be conducted to ensure that everyone understands what retaliation is and knows the steps that can and cannot be taken once someone reports internally or to the government. Zero tolerance policies that are advertised to the workforce can help employees get comfortable reporting internally rather than straight to the governmental authorities.

### Domestic and International Policies

Review and update both domestic and international policies. In light of the purported award in the PAC case, companies should be aware that whistleblower tips may arise from and with respect to any part of their business, including activity overseas. In FY 2020, 11 percent of whistleblower submissions to the Commission were submitted from non-US countries.[13] Since the inception of the program, the SEC has received tips from whistleblowers in 130 countries. Properly and consistently implemented robust internal reporting mechanisms and whistleblower policies provides an additional safeguard for compliance with US and international laws and regulations.

## Notes

1. 15 U.S.C. § 78u-6.
2. 17 C.F.R. §§ 240.21F-7; 15 U.S.C. § 78u-6(h)(1).
3. 15 U.S.C. § 78u-6(a)(1); 17 C.F.R. §§ 240.21F-10(a).
4. 17 C.F.R. §§ 240.21F-10(a).
5. 17 C.F.R. §§ 240.21F-11.
6. *https://www.sec.gov/news/press-release/2021-91*.
7. *See, e.g.,* Order Determining Whistleblower Award Claim, Release No. 91805 (May 10, 2021); Order Determining Whistleblower Award Claim, Release No. 89002 (June 4, 2020); Order Determining Whistleblower Award Claim, Release No. 85412 (March 26, 2019).
8. *https://www.sec.gov/news/press-release/2021-86*.
9. *https://www.sec.gov/page/whistleblower-100million*.
10. *https://www.wsj.com/articles/whistleblower-is-awarded-28-million-in-panasonic-avionics-case-11621443228*.
11. *https://www.justice.gov/opa/pr/panasonic-avionics-corporation-agrees-pay-137-million-resolve-foreign-corrupt-practices-act; https://www.sec.gov/news/press-release/2018-73*.
12. *https://www.sec.gov/files/2020 Annual Report_0.pdf*.
13. *Id.*

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