

THE REVIEW OF  
**SECURITIES & COMMODITIES  
REGULATION**

AN ANALYSIS OF CURRENT LAWS AND REGULATIONS  
AFFECTING THE SECURITIES AND FUTURES INDUSTRIES

Vol. 54 No. 10 May 19, 2021

**PRE-PUBLICATION ISSUE**

**SEC ENFORCEMENT WILL EXPAND ITS POLICING OF  
PUBLIC COMPANIES UNDER THE BIDEN ADMINISTRATION**

*The SEC has already taken steps signaling a more aggressive enforcement stance in 2021. In this article the authors note this trend and project likely future enforcement activities based on a look back at 2020 activities and areas (such as ESG) prioritized by the new administration. They conclude with steps public companies can take to mitigate the risk of SEC Enforcement scrutiny.*

By Peter K.M. Chan, Amy J. Greer, and Kristal D. Petrovich \*

Under the Biden Administration, the U.S. Securities and Exchange Commission is expected to be aggressive in bringing enforcement actions against alleged corporate wrongdoers.<sup>1</sup> In fact, the stage is already set for a broad

---

<sup>1</sup> For instance, signalling a more aggressive enforcement stance, the SEC restored the power of SEC senior officers to approve the issuance of formal orders of investigation (the basis for issuance of SEC investigative subpoenas) without approval by SEC Commissioners. Allison Herren Lee, *Statement of Acting Chair Allison Herren Lee on Empowering Enforcement to Better Protect Investors* (Feb. 9, 2021) available at <https://www.sec.gov/news/public-statement/lee-statement-empowering-enforcement-better-protect-investors>. And as an indication of tougher SEC enforcement, the SEC took recent action to reinforce what it described as the critical separation between the SEC's enforcement process and its consideration of requests for waivers from automatic disqualifications that arise

range of SEC enforcement activities in the corporate arena based on actions the SEC brought in 2020. A review of these recent SEC enforcement actions shows that the SEC has taken a broad and expansive approach in scope and subject matter, investigative techniques, and legal theories of its cases against public companies, even though the number of cases remained flat when compared to the previous year.

---

*footnote continued from previous column...*

from certain violations or sanctions. As such, the Division of Enforcement will no longer recommend to the Commission a settlement offer that is conditioned on granting a waiver. Allison Herren Lee, *Statement of Acting Chair Allison Herren Lee on Contingent Settlement Offers* (Feb. 11, 2021) available at <https://www.sec.gov/news/public-statement/lee-statement-contingent-settlement-offers-021121>.

---

*\* PETER CHAN is a partner in Baker McKenzie's North America Financial Regulation and Enforcement Practice. Peter served as assistant regional director at the SEC's Chicago regional office. AMY GREER serves as the co-chair of Baker McKenzie's North America Financial Regulation and Enforcement Practice. Amy served as chief trial counsel at the SEC's Philadelphia regional office. KRISTAL PETROVICH is an associate in Baker McKenzie's Financial Regulation and Enforcement Practice. Their e-mail addresses are peter.chan@bakermckenzie.com, amy.greer@bakermckenzie.com, and kristal.petrovich@bakermckenzie.com.*

---

**INSIDE THIS ISSUE**

•

In addition to its focus on traditional corporate accounting and auditor matters, the SEC continued to expand its reach into alleged disclosure failures involving non-accounting areas of a company, such as misstatements regarding compliance with environmental regulations. The SEC also continued to take action against foreign issuers. Auditors remain a focus of the agency in connection with enforcement investigations of corporate accounting irregularities. In addition, the SEC expanded its investigative techniques by leveraging data analytics to detect potential corporate misconduct to focus on what it views to be high-risk corporate behavior. Finally, instead of its typical reliance on the antifraud provisions of the federal securities laws, the SEC, in what could be a precedent-setting settlement, creatively applied a non-fraud internal controls case theory to an insider-trading matter.

We expect the SEC, and the Division of Enforcement, will likely build upon this expansive momentum. For instance, we can anticipate that the SEC will scrutinize corporate disclosure in areas prioritized by the new administration, such as corporate conduct involving environment, social, and governance (“ESG”) issues. As a result, public companies should adapt their compliance and risk programs to this new enforcement environment.

## **A LOOK BACK AT SEC ENFORCEMENT CASES INVOLVING PUBLIC COMPANIES**

### ***Ongoing Focus on Traditional Corporate Accounting Cases and Cases Involving Non-GAAP Metrics***

In 2020, the SEC continued to bring enforcement actions against public companies and their executives for traditional GAAP accounting misstatements. Public company accounting cases tend to be one of the key areas where the SEC actually charges high-level corporate personnel. For example, the Commission brought actions against:

- a lighting products company and four executives, including the CEO and former CFO, alleging that

they falsely inflated the company’s reported revenues over a four-year period;<sup>2</sup>

- a producer of computer servers and its former CFO, alleging that they prematurely recognized revenue and understated expense over a period of at least three years;<sup>3</sup> and
- a brand management company and its former CEO and COO, for allegedly devising a fraudulent scheme to create fictitious revenue, allowing the company to meet or beat Wall Street analysts’ consensus estimates in the second and third quarters of 2014.<sup>4</sup>

In the past year, the SEC has also continued to bring actions against public companies for misstatements involving non-GAAP financial metrics. For instance, it charged a pharmaceutical company and three former executives for touting double-digit, same-store organic growth, a non-GAAP financial measure, when the growth came primarily from sales to a mail order pharmacy owned by the pharmaceutical company.<sup>5</sup> Similarly, the SEC charged a global alcohol producer for failing to make required disclosures of known trends relating to the shipments to distributors of unneeded products by its North American subsidiary.<sup>6</sup>

### ***Broad Scope and Subject Matter***

While continuing to police public companies on their accounting disclosures, the Division of Enforcement also

---

<sup>2</sup> Case No. 3:20-cv-01440 (D. Conn. Sept. 24, 2020) *available at* <https://www.sec.gov/litigation/complaints/2020/comp-pr2020-221.pdf>.

<sup>3</sup> File No. 3-19927 (Aug. 25, 2020) *available at* <https://www.sec.gov/litigation/admin/2020/33-10822.pdf>.

<sup>4</sup> Case No. 1:19-cv-11150 (S.D.N.Y Dec. 5, 2019) *available at* <https://www.sec.gov/litigation/complaints/2019/comp-pr2019-251-iconix.pdf>.

<sup>5</sup> File No. 3-19899 (July 31, 2020) *available at* <https://www.sec.gov/litigation/admin/2020/33-10809.pdf>.

<sup>6</sup> File No. 3-19701 (Feb. 19, 2020) *available at* <https://www.sec.gov/litigation/admin/2020/33-10756.pdf>.

---

has successfully brought enforcement actions based on corporate disclosure regarding a variety of non-accounting subjects. Further, the SEC has continued to focus on companies that are primarily non-U.S. entities that have listed securities or sold bonds in the U.S. While the underlying legal theory for these cases is not new, there is plainly a greater willingness by the Division of Enforcement to apply its relatively scarce resources to broadly cover allegedly misleading or incomplete corporate disclosure.

For example, the SEC alleged that a global original equipment manufacturer of motor vehicles had made misleading disclosures about an internal audit of its emissions control systems.<sup>7</sup> The company's common stock is registered under Section 12(b) of the Securities Exchange Act of 1934 and it files annual reports with the Commission on Form 20-F. In February 2016, following the Volkswagen "Dieselgate" emission scandal, the SEC alleged that the manufacturer represented in both a press release and its annual report that the manufacturer conducted an internal audit and found that its vehicles complied with environmental emissions regulations.<sup>8</sup>

However, at the time the company made these statements, the SEC found that engineers at the U.S. Environmental Protection Agency and California Air Resource Board raised concerns to the company about the emissions systems in certain of its diesel vehicles. The SEC alleged that the company's public assurance of its corporate environmental compliance was misleading and did not sufficiently disclose the limited scope of its internal audit. As a result, the SEC found that the company violated the reporting requirements under Section 13 of the Exchange Act.<sup>9</sup>

---

<sup>7</sup> File No. 3-20092 (Sept. 28, 2020) *available at* <https://www.sec.gov/litigation/admin/2020/34-90031.pdf>.

<sup>8</sup> In yet another enforcement case against a non-US car company, the SEC charged a Germany-based automaker and two of its U.S. subsidiaries for disclosing inaccurate information about retail sales volume in the U.S., while raising approximately \$18 billion from investors in several corporate bond offerings. File No. 3-20060 (Sept. 24, 2020) *available at* <https://www.sec.gov/litigation/admin/2020/33-10850.pdf>.

<sup>9</sup> In another disclosure case that did not involve any accounting issues, the SEC charged a South Carolina electric and gas company and two of its former top executives for making false and misleading statements about a nuclear power plant expansion that was behind schedule and ultimately abandoned. Case No. 3:20-cv-00882-MGL (Feb. 27, 2020) *available at*

Looking ahead, the SEC may leverage enforcement cases involving alleged disclosure failures regarding non-accounting issues to indirectly effect corporate conduct in areas such as ESG. The Biden Administration has made clear that it is a priority to promote good corporate ESG practice. The SEC has also indicated that ESG is a priority.<sup>10</sup> Indeed, it has recently created a Climate and ESG Task Force in the Division of Enforcement to "proactively identify ESG-related misconduct."<sup>11</sup> As part of its ESG focus, the SEC may scrutinize public companies that have made disclosures promoting their ESG values and/or conduct in their SEC filings or in other public statements. If the SEC identifies what it views to be material misstatements or omissions, or if actual conduct fails to match aspirational statements, the agency may charge such companies with violations of the antifraud or reporting provisions of the federal securities laws.

### ***Ongoing Focus on Auditors***

The SEC also continues to focus on the role of outside auditors in connection with financial misstatements by public companies. For example, the SEC brought a significant enforcement action against the Mexican affiliate of a major international audit firm, an engagement partner, and a senior manager, in connection

---

*footnote continued from previous page...*

<https://www.sec.gov/litigation/complaints/2020/scana-complaint-022720.pdf>.

<sup>10</sup> The SEC has recently appointed a Senior Policy Advisor for Climate and ESG (a newly created senior position) to advise the agency on ESG matters and advance related new initiatives. SEC, Press Release, *Satyam Khanna Named Senior Policy Adviser for Climate and ESG* (Feb. 2, 2020) *available at* <https://www.sec.gov/news/press-release/2021-20>. Acting Chair Lee also directed the Division of Corporation Finance to enhance its focus on climate-related disclosure in public company filings and assess compliance with disclosure obligations regarding climate-related risks. Alison Herren Lee, *Statement on the Review of Climate-Related Disclosure* (Feb. 24, 2021) *available at* <https://www.sec.gov/news/public-statement/lee-statement-review-climate-related-disclosure>. She also outlined her plan for the SEC to be "fully engaged in confronting the risks and opportunities that climate and ESG pose for investors, our financial system, and our economy." Lee, *A Climate for Change: Meeting Investor Demand for Climate and ESG Information at the SEC* (Mar. 15, 2021) <https://www.sec.gov/news/speech/lee-climate-change>.

<sup>11</sup> SEC, Press Release, *SEC Announces Enforcement Task Force Focused on Climate and ESG Issues* (Mar. 4, 2021) *available at* <https://www.sec.gov/news/press-release/2021-42>.

---

with alleged improper professional conduct in their audits of a Mexico-based home construction company that was dually listed on the Mexican Stock Exchange and the New York Stock Exchange.<sup>12</sup> In the settled order, the SEC noted that the audit firm and the individual professionals actually identified fraud as a potential risk and were aware that the company was being investigated by the SEC. The respondents had even put in place a “close monitoring” risk designation for one of the audits. Despite these red flags, the SEC alleged that the audit firm and its two audit professionals failed to obtain sufficient audit evidence during their audits. In particular, the SEC alleged that the audit firm was encountering “personnel limitations” and failed to adequately train and supervise team members drawn from various offices to perform the audits.

This enforcement action reflects the SEC’s ongoing concerns with auditors who fail to recognize and respond to red flags of fraud. Consistent with past enforcement actions, the SEC also continues to focus on audit firms that fail to allocate sufficient resources or adequately staff difficult or high-risk audits with properly trained and supervised professionals.

Even when the SEC does not find fault with an auditor, the auditor and its professionals are often an integral part of the SEC’s investigation of corporate financial misstatements and may even serve as key witnesses in the SEC case. For example, in an SEC enforcement action this past year against trucking company executives for alleged accounting fraud involving sham transactions, the SEC highlighted that the defendants had lied to the company’s outside auditor when they claimed that the pricing in the transactions was determined and evaluated independently, and also by concealing their roles in negotiating and approving the transactions.<sup>13</sup>

Because we anticipate that the SEC will closely review auditor conduct in investigations of public companies involved in potential accounting irregularities or other misstatements, public companies should expect their auditors to be even more aggressive in seeking management representations and audit evidence, especially when they encounter red flags of improprieties.

### ***Expanded Case Generation Techniques Using Data Analytics***

The SEC continues to expand its use of data analytics as an investigative tool. For example, the SEC announced the Division of Enforcement’s EPS (Earnings Per Share) Initiative, which utilizes risk-based data analytics to uncover potential accounting and disclosure violations caused by, among other things, earnings management practices. In September of 2020, as part of the initiative, the SEC charged two public companies for violations that resulted in the improper reporting of quarterly EPS that met or exceeded analyst consensus estimates.<sup>14</sup> As demonstrated by this enforcement initiative, the SEC remains concerned that the desire to meet or exceed analyst expectations continues to tempt corporate executives to “cook the books.”

Additionally, the Division of Enforcement has been using risk-based data analytics to uncover potential violations related to failure to disclose corporate perquisites in proxy statements. As part of this initiative, the SEC recently charged an Oklahoma-based gas exploration company and its former CEO for failing to properly disclose certain perks, including use of chartered aircraft and related-person transactions.<sup>15</sup> We believe there is a strong likelihood that the SEC Enforcement staff developed this initiative based on observations shared by the SEC’s Division of Corporation Finance regarding problematic proxy filings.

Because of the massive amount of data collected by the agency and its increasing internal development of data analytics tools, it is likely that the SEC will bring additional enforcement cases based on such analyses. One area where the SEC may launch a data analytics initiative is special purpose acquisition companies (“SPACs”). SPACs have become a very popular vehicle for companies to go public without going through the initial public offering process. Some, including former SEC Chair Jay Clayton when he was at the SEC, have expressed concerns regarding disclosure and potential

---

<sup>14</sup> File No. 3-20084 (Sep. 28, 2020) *available at* <https://www.sec.gov/litigation/admin/2020/34-90017.pdf>; File No. 3-20085 (Sep. 28, 2020) *available at* <https://www.sec.gov/litigation/admin/2020/33-10854.pdf>.

<sup>15</sup> File No. 3-20232 (Feb. 24, 2021) *available at* <https://www.sec.gov/litigation/admin/2021/34-91196.pdf> and File No. 3-20232 (Feb. 24, 2021) *available at* <https://www.sec.gov/litigation/admin/2021/34-91196.pdf>.

---

<sup>12</sup> File No. 3-20173 (Dec. 17, 2020) *available at* <https://www.sec.gov/litigation/admin/2020/34-90699.pdf>.

<sup>13</sup> Case No. 1:19-cv-4804 (S.D. Ind. Dec. 5, 2019) *available at* <https://www.sec.gov/news/press-release/2019-253>.

---

conflicts issues regarding SPAC transactions.<sup>16</sup> The SEC may thus launch an initiative and use data analytics to look for disclosure and other deficiencies involving SPACs.<sup>17</sup>

### ***The SEC's (Unduly?) Broad Interpretation of Internal Controls***

In an unusual case, the SEC has taken an expansive view of the types of public company internal controls that constitute “accounting” controls within the SEC’s regulatory purview under Exchange Act Section 13(b)(2)(B). As a result, if this precedent were followed, any deficiency or breach of internal corporate compliance policy could constitute a violation of internal accounting controls under the provision.

On October 15, 2020, the SEC issued a settled administrative order charging a Texas-based energy company with failing to devise and maintain adequate internal controls related to its buyback of company stock pursuant to a Rule 10b5-1 plan.<sup>18</sup> In an unprecedented move, the Commission applied an internal accounting controls legal theory under Section 13(b)(2)(B) of the Exchange Act to an insider trading policy compliance context.<sup>19</sup>

According to the SEC’s order, the Board of Directors’ authorization for the stock buyback was subject to a company policy prohibiting repurchases while the company was in possession of material non-public information (“MNPI”). The SEC took the view that the company was in possession of MNPI at the time of the buyback. While the facts sound ripe for an insider trading case, the respondent company, at the time of the events, took steps to confirm it *did not* possess MNPI, and that was the company’s view of the information. As a result, the SEC apparently could not allege the requisite scienter under the Section 10(b) and Rule 10b-5 insider trading theory. So, rather than trying to pursue an insider trading case, the SEC instead charged the company under an internal accounting controls theory.

On November 13, 2020, Commissioners Hester Peirce and Elad Roisman issued a rare public statement explaining why they had dissented from and voted against the settlement.<sup>20</sup> Pierce and Roisman opined that the finding rested on an “unduly broad view of Section 13(b)(2)(B),” stating that “[s]ince Section 13(b)(2)(B)’s enactment in 1977, the Commission has never before found that the “internal accounting controls” required by that provision include management’s assessment of a company’s potential insider trading liability.” The Commissioners cautioned against a temptation to view this “internal controls” provision as “generic,” affecting any corporate assets and transactions. Since Commissioners Peirce and Roisman represented a minority view, this expansive interpretation of internal controls appears to be the current position of the Commission.

Perhaps this settlement is simply an isolated case, where the SEC pushed the boundary of internal accounting controls because it wanted to act against the company for incorrectly determining whether it possessed MNPI. But per Commissioners Roisman and Peirce’s dissenting statement, this case does provide a precedent for the SEC to potentially use internal controls to influence non-accounting corporate conduct. For instance, the agency may be tempted to bring an internal

---

<sup>16</sup> CNBC, *SEC Chairman Jay Clayton on disclosure concerns surround going public through a SPAC* (Sept. 24, 2020) available at <https://www.msn.com/en-us/money/watch/sec-chairman-jay-clayton-on-disclosure-concerns-surround-going-public-through-a-spac/vp-BB19nY8Z>.

<sup>17</sup> As we have seen from the recent announcements of the two data analytics initiatives, the SEC may have already launched such an initiative. Generally, the staff waits to announce an initiative until the agency is ready to bring an enforcement action.

<sup>18</sup> File No. 3-20125 (Oct. 15, 2020) available at <https://www.sec.gov/litigation/admin/2020/34-90208.pdf>.

<sup>19</sup> Section 13(b)(2)(B) of the Exchange Act provides that an issuer must devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that: (i) transactions are executed in accordance with management’s general or specific authorization; (ii) transactions are recorded as necessary (I) to permit preparation of financial statements in conformity with generally accepted accounting principles or any other criteria applicable to such statements, and (II) to maintain accountability for assets; (iii) access to assets is permitted only in accordance with management’s general or specific authorization; and (iv) the recorded accountability for assets is compared with the existing assets at reasonable

---

*footnote continued from previous page...*

intervals and appropriate action is taken with respect to any differences.

<sup>20</sup> SEC, Public Statement, *Statement of Commissioners Hester M. Peirce and Elad L. Roisman* (Nov. 13, 2020), <https://www.sec.gov/news/public-statement/peirce-roisman-andeavor-2020-11-13>.

---

controls case against a company having inadequate policies and procedures for cybersecurity in connection with a significant breach, even if the breach is timely disclosed and even though there is no specific cybersecurity requirements for public companies under the federal securities laws.

### *Enforcement Coronavirus Steering Committee*

On May 12, 2020, Steven Peikin, then Co-Director of the SEC's Division of Enforcement, announced in a speech that Enforcement had created a Coronavirus Steering Committee to coordinate the Division of Enforcement's response to coronavirus-related enforcement issues.<sup>21</sup> The committee would focus, among other things, on corporate disclosure and accounting fraud, such as preexisting accounting and disclosure improprieties exposed by the then-current down market, or misstatements regarding the impact from the current crisis.

Just over six months later, in December 2020, the SEC announced settled charges against a national restaurant chain for making misleading disclosures about the impact of COVID-19 on its business operations and financial condition.<sup>22</sup> It was the SEC's first action charging a public company for misleading investors about the impact of the pandemic. The SEC found that the company violated the reporting provisions of the Exchange Act for inaccurately describing in its Forms 8-K filed March and April 2020 that the company's restaurants were transitioning to an "off-premises model" involving to-go and delivery that was "enabling the Company's restaurants to operate sustainably at present under this current model." The SEC found that the company's claim of operational sustainability was misleading because the company at the time had only 16 weeks of cash remaining and it had informed its landlords that the company would not pay April rent.

With the establishment of the Coronavirus Steering Committee to shepherd and coordinate investigations, there will likely be more enforcement actions alleging misstatements stemming from the impact of COVID-19 on public companies.

## **HOW TO MITIGATE RISK OF SEC ENFORCEMENT SCRUTINY**

Public companies and their legal and compliance teams should develop a situational awareness as to when certain corporate conduct may trigger the interest of the SEC Enforcement staff in this tough enforcement environment. As a start, public companies need to factor into their risk assessment and management that conduct and practices beyond traditional accounting matters may now be subject to SEC enforcement inquiry for potential disclosure and internal control deficiencies. For instance, companies should mean what they say when it comes to touting their ESG practices to the public or in establishing internal ESG policies and goals. Aspirational statements can seem like a positive, and are particularly effective at motivating company employees, especially when they come from the C-suite; but if conduct that conflicts with the public pronouncements is discovered, the SEC can turn these statements into evidence against the company. Corporate legal and compliance teams should monitor their companies' statements to ensure that there is some room for flexibility amid the ambition.

Public companies should also consider augmenting and calibrating their disclosure and compliance process in this new reality. Now that the SEC is laser-focused on disclosure regarding operational and non-accounting regulatory issues, persons familiar with these issues should have a seat at the table in deciding what may be material information requiring disclosure. In addition, because of the prevalence of data-analytics initiatives by the SEC, companies should be aware of, and identify legitimate explanations for, outliers in key financial metrics compared to their peers or if such metrics reflect an anomaly as compared with the company's own historical trends.

To avoid finding themselves under scrutiny, auditors should redouble their efforts to follow-up on red flags and clearly document responses from management on these issues. These simple actions can be the difference between being a defendant or a material witness in an SEC enforcement action. In addition, audit firms should consider their systems for monitoring staff and resources, as the SEC continues to focus on whether auditors have the appropriate professional personnel assigned to audits.

Finally, companies should consider whether to include in-house or outside counsel with a good understanding of the SEC enforcement mindset in any difficult SEC-related compliance or risk assessment, examination or investigation. ■

---

<sup>21</sup> Steven Peikin, *Keynote Address: Securities Enforcement Forum West 2020* (May 12, 2020), available at <https://www.sec.gov/news/speech/keynote-securities-enforcement-forum-west-2020>.

<sup>22</sup> File No. 3-20158 (Dec. 4, 2020) available at <https://www.sec.gov/news/press-release/2020-306>.