

February 15, 2024

SEC Enforcement: 2023 Year in Review

During the third year of Chair Gary Gensler's and Director of Enforcement Gurbir Grewal's leadership, several key enforcement priorities for the SEC impacted and will likely continue to impact businesses across a range of sectors for years to come. In this year in review, we highlight important takeaways for business leaders and in-house counsel from the Division's activities in 2023, and what these activities suggest for the Division's priorities for the year ahead.

Highlights:

- **Aggressive Positions Lead to Increased Penalties:** The SEC obtained a near record amount of \$4.9 billion in penalties in 2023.¹ As in 2022, these penalties were significantly bolstered by investigative "sweeps," including enforcement actions against broker dealers relating to the use of "off-channel" electronic communications, such as text messages, that resulted in more than \$400 million in penalties.² The SEC also obtained admissions from corporate defendants in several of these matters.
- **High-Profile and Novel Cryptocurrency Actions:** The SEC brought a total of 46 cryptocurrency-related enforcement actions in 2023; a 53% increase from 2022.³ There continues to be much litigation around the threshold issue of which digital assets will be considered securities subject to, among other things, the registration requirements of the securities laws. In 2023, the SEC suffered a high-profile loss in the Ripple matter in which a district court judge held that Ripple's sale of XRP to buyers on digital asset exchanges did not constitute the offer or sale of securities. The SEC also brought a number of high-profile enforcement actions in 2023 whose resolution will turn on that question. Most notably, the SEC charged two prominent cryptocurrency exchanges, Binance and Coinbase, for operating as unregistered exchanges. These and other similar enforcement actions related to cryptocurrency advanced novel enforcement theories that will be litigated in courts across the country in 2024 and beyond.
- **Increase in Climate and ESG Disclosures:** The SEC remained active in the ESG space, filing several ESG-related enforcement actions in 2023 that foreshadow areas of focus for 2024 and beyond. The market also continues to await significant ESG rulemaking by the SEC, which is expected to be finalized in April 2024.
- **Trends in Insider Trading, Cybersecurity, SPACs, and Other Critical Areas:** There were a number of other notable developments in enforcement and rulemaking activities relating to cyber disclosures, SPACs and insider trading.

¹ SEC Press Release, SEC Announces Enforcement Results for Fiscal Year 2023 (Nov. 14, 2023), <https://www.sec.gov/news/press-release/2023-234>.

² SEC Press Release, SEC Charges 10 Firms with Widespread Recordkeeping Failures (Sept. 29, 2023), <https://www.sec.gov/news/press-release/2023-212>.

³ <https://www.cornerstone.com/wp-content/uploads/2024/01/SEC-Cryptocurrency-Enforcement-2023-Update.pdf>.

The Year in Review

Chair Gary Gensler and Director of Enforcement Gurbir Grewal had a busy year. In fiscal year 2023, the SEC brought a total of 784 actions, including 501 new “standalone” actions, an 8% increase in the number of actions from 2022.⁴ The SEC also obtained \$4.949 billion in penalties, the highest amount ever recovered (other than in 2022).⁵

Policy Shifts in Action: Increased Penalties, Required Undertakings and Admissions, and Emphasis on Cooperation and Rewarding Whistleblowers

As discussed in our 2022 Year in Review, since his appointment in 2021, Director Grewal has spoken frequently about the Enforcement Division’s intention to require admissions of wrongdoing in certain enforcement actions and to seek increased penalties that effectively “deter misconduct and meaningfully hold bad actors accountable.”⁶ Director Grewal concluded 2022 by reaffirming the Enforcement Division’s view that “[m]arket participants must realize that complying with securities laws is cheaper than violating those laws” and calling admissions an “incredibly powerful accountability measure” that the staff will “continue seeking.”⁷

Both of these policy agendas played out in 2023. With respect to penalties, as mentioned above, the SEC obtained the second-highest amount of financial remedies in its history during fiscal year 2023. During that time, according to Cornerstone Research reports, the SEC obtained admissions from 16 public company or subsidiary defendants, which tied last year’s record-high total.⁸ But the SEC has tended to obtain admissions under circumstances not likely to have significant collateral consequences (*i.e.*, in private civil class actions or in parallel criminal proceedings), which lessens the true impact of obtaining those admissions.⁹ In point of fact, none of the settled actions in 2023 against corporate defendants that included admissions involved scienter or fraud-based claims and therefore are unlikely to materially impact risks for those companies in private securities litigation or other traditional collateral consequences.

Finally, in 2023 the SEC’s whistleblower program issued a total of nearly \$600 million in awards, including an award of \$279 million to a single whistleblower—the SEC’s largest ever award—in connection with a 2019 FCPA case.¹⁰

Greater Reliance on Sweeps

Broad investigative sweeps for specific types of misconduct significantly contributed to increased enforcement activity this past year, particularly contributing to the significant fines collected.

For example, the SEC secured \$400 million in settlements with 25 advisory firms, broker-dealers, and credit rating agencies for violations of recordkeeping provisions of federal securities laws.¹¹ Those actions involved allegations that employees at each of the firms were using off-channel communications to discuss business affairs, and that the firms had failed to maintain or

⁴ SEC Press Release, SEC Announces Enforcement Results for Fiscal Year 2023 (Nov. 14, 2023), <https://www.sec.gov/news/press-release/2023-234>.

⁵ *Id.*

⁶ SEC Speech, Remarks at Securities Enforcement Forum (Nov. 15, 2022), <https://www.sec.gov/news/speech/grewal-speech-securities-enforcement-forum-111522>; https://www.paulweiss.com/media/3983014/sec_enforcement_2022_year_in_review.pdf (“2022 Year in Review”).

⁷ *Id.*

⁸ Cornerstone Research, *SEC Cryptocurrency Enforcement* (2024) at 8, <https://www.cornerstone.com/wp-content/uploads/2023/11/SEC-Enforcement-Public-Companies-Subsidiaries-FY2023.pdf>.

⁹ Harris Fischman, *SEC Admissions Policy Hasn’t Led To Big Consequences* (Feb. 28, 2023), Law360, <https://www.law360.com/articles/1579399>.

¹⁰ SEC Press Release, SEC Announces Enforcement Results for Fiscal Year 2023 (Nov. 14, 2023), <https://www.sec.gov/news/press-release/2023-234>; Mengqi Sun, *Record \$279 Million Whistleblower Award Went to a Tipster on Ericsson*, W.S.J., (May 26, 2023), <https://www.wsj.com/articles/record-279-million-whistleblower-award-went-to-a-tipster-on-ericsson-5af40b98>.

¹¹ *Id.*

preserve such communications.¹² The firms paid combined penalties of \$79 million; were ordered to cease and desist from future violations; were censured; and agreed to retain independent compliance experts to review and improve their recordkeeping policies.¹³ The one firm that self-reported paid a \$2.5 million penalty in contrast to the penalties paid by the firms that did not self-report, ranging from \$8 million to \$35 million.¹⁴

Another recent Enforcement Division sweep focused on the Marketing Rule, which requires investment advisors to adopt and implement certain policies and procedures in order to be allowed to include statements about hypothetical performance in their advertisements.¹⁵ The sweep resulted in charges against nine investment advisors for advertising hypothetical performance to the general public on their websites without adopting or implementing the necessary policies and procedures.¹⁶ The firms agreed to settle and pay penalties totaling \$850,000; were censured; were ordered to cease and desist from violating the charged provisions; and were ordered to comply with certain undertakings.¹⁷

Finally, the SEC brought 11 actions based on company insiders' failure to complete Form 4 and Schedules 13D and 13G in connection with their holdings of company stock.¹⁸ Director Grewal indicated in public remarks that the transactions at issue had a total value of more than \$90 million.¹⁹

SEC Chair Gensler's Areas of Focus

As we reported in our 2022 Year in Review, Chair Gensler has repeatedly emphasized his plan to focus resources and attention on issues related to cryptocurrency and climate and Environmental, Social, & Governance ("ESG") issues. Below, we check in on significant enforcement activity and rulemaking in these spaces, as well as other significant matters from the past year.

Cryptocurrency

As in 2022, the SEC was laser-focused on cryptocurrency in 2023. The SEC brought a total of 46 cryptocurrency-related enforcement actions, which is the highest number of actions since the SEC first began bringing cryptocurrency-related actions in 2013, and a 53% increase from 2022.²⁰ This spike in enforcement activity follows the Division of Enforcement's announcement in May 2022 that it was nearly doubling its Crypto Assets and Cyber Unit.²¹ Moreover, Chair Gensler stayed consistent with his

¹² SEC Press Release, SEC Charges 10 Firms with Widespread Recordkeeping Failures (Sept. 29, 2023), <https://www.sec.gov/news/press-release/2023-212>.

¹³ *Id.*

¹⁴ *Id.*

¹⁵ SEC Press Release, Violations Results in Charges Against Nine Investment Advisers (Sept. 11, 2023), <https://www.sec.gov/news/press-release/2023-173>.

¹⁶ *Id.*

¹⁷ *Id.*

¹⁸ Press Release, SEC Charges Corporate Insiders for Failing to Timely Report Transactions and Holdings (Sept. 27, 2023), <https://www.sec.gov/news/press-release/2023-201>.

¹⁹ *Id.*

²⁰ Cornerstone Research, *SEC Cryptocurrency Enforcement (2024)* at 1, <https://www.cornerstone.com/wp-content/uploads/2024/01/SEC-Cryptocurrency-Enforcement-2023-Update.pdf>.

²¹ SEC Press Release, SEC Nearly Doubles Size of Enforcement's Crypto Assets and Cyber Unit (May 3, 2022), <https://www.sec.gov/news/press-release/2022-78>.

public messaging regarding the SEC’s focus on cryptocurrency, calling it a “highly noncompliant field.”²² There are no signs that Gensler’s focus on cryptocurrency will waiver anytime soon.

Although the SEC brought a wide range of cryptocurrency enforcement actions in 2023, it most commonly alleged fraud and non-compliance with registration obligations.²³ The latter allegation, as discussed in our 2022 Year in Review, is a product of the SEC’s view that most cryptocurrencies qualify as investment contracts under the 1946 Supreme Court case *SEC v. W.J. Howey Co.*, something Chair Gensler continued to emphasize.²⁴

The SEC suffered a significant defeat on this critical threshold issue in its long-running legal battle with Ripple.²⁵ Most notably, the court held that Ripple’s sale of XRP to buyers on digital asset exchanges did not constitute the offer or sale of securities. The court also rejected the SEC’s arguments that Ripple used institutional buyers as underwriters to sell XRP to the public. And in October 2023, the SEC dismissed its remaining claims against Ripple’s co-founder and Executive Chairman and Ripple’s CEO. The extent to which this decision will mean in other cases that secondary transactions in crypto assets on centralized and decentralized crypto exchanges are not transactions in “securities” will continue to be litigated throughout the country in 2024 and likely beyond.

Litigation setbacks aside, the SEC continued to bring significant enforcement actions in this space in 2023. In June 2023, on back-to-back days, the SEC brought charges against two well-known exchanges—Binance and Coinbase—for, among other things, operating as unregistered securities exchanges.²⁶ These charges followed those brought against other prominent intermediaries, Genesis, Gemini and Kraken, at the beginning of 2023 for allegedly offering unregistered securities through crypto lending and staking programs.²⁷ The SEC brought additional charges against Kraken in November 2023 for operating as an unregistered exchange.²⁸

A separate area of focus of the SEC this year in the cryptocurrency space was the issue of “touting,” which refers to influencers who unlawfully touted crypto assets without disclosing the compensation they received to do so. The SEC resolved several “touting” actions in 2023, including with NBA Hall of Famer Paul Pierce, media personality Kim Kardashian, and other celebrities.²⁹

²² SEC Speech, “Partners of Honest Business and Prosecutors of Dishonesty”: Remarks Before the 2023 Securities Enforcement Forum (Oct. 25, 2023), <https://www.sec.gov/news/speech/gensler-remarks-securities-enforcement-forum-102523>.

²³ Cornerstone Research, *SEC Cryptocurrency Enforcement* (2024) at 5, <https://www.cornerstone.com/wp-content/uploads/2024/01/SEC-Cryptocurrency-Enforcement-2023-Update.pdf>.

²⁴ SEC Speech, “Partners of Honest Business and Prosecutors of Dishonesty”: Remarks Before the 2023 Securities Enforcement Forum (Oct. 25, 2023), <https://www.sec.gov/news/speech/gensler-remarks-securities-enforcement-forum-102523>.

²⁵ *Sec. & Exch. Comm’n v. Ripple Labs, Inc.*, No. 20 CIV. 10832 (AT), 2023 WL 4507900 (S.D.N.Y. July 13, 2023), motion to certify appeal denied, No. 20 CIV. 10832 (AT), 2023 WL 6445969 (S.D.N.Y. Oct. 3, 2023); <https://www.paulweiss.com/practices/litigation/cryptocurrency-blockchain/news/ripple-labs-co-founder-cleared-of-all-allegations-in-landmark-sec-crypto-enforcement-action?id=48691>.

²⁶ SEC Press Release, SEC Files 13 Charges Against Binance Entities and Founder Changpeng Zhao (Jun. 5, 2023), <https://www.sec.gov/news/press-release/2023-101>; SEC Press Release, SEC Charges Coinbase for Operating as an Unregistered Securities Exchange, Broker, and Clearing Agency (Jun. 6, 2023), <https://www.sec.gov/news/press-release/2023-102>.

²⁷ SEC Press Release, SEC Charges Genesis and Gemini for the Unregistered Offer and Sale of Crypto Asset Securities through the Gemini Earn Lending Program (Jan. 12, 2023), <https://www.sec.gov/news/press-release/2023-7>; SEC Press Release, Kraken to Discontinue Unregistered Offer and Sale of Crypto Asset Staking-As-A-Service Program and Pay \$30 Million to Settle SEC Charges (Feb. 9, 2023), <https://www.sec.gov/news/press-release/2023-25>.

²⁸ SEC Press Release, SEC Charges Kraken for Operating as an Unregistered Securities Exchange, Broker, Dealer, and Clearing Agency (Nov. 20, 2023), <https://www.sec.gov/news/press-release/2023-237>.

²⁹ SEC Press Release, SEC Announces Enforcement Results for Fiscal Year 2023 (Nov. 14, 2023), <https://www.sec.gov/news/press-release/2023-234>.

2023 also saw the SEC's first ever actions against issuers of non-fungible tokens (NFTs). The SEC's charges against two separate NFT issuers followed the same pattern as the SEC's allegations against exchanges, alleging the NFT issuers engaged in unregistered offerings of securities by offering and selling NFTs to consumers.³⁰ However, unlike Coinbase, Binance, and Kraken, the NFT issuers each agreed to enter into cease-and-desist orders and pay civil penalties.³¹

ESG

Although ESG remains a top priority for the Enforcement Division in the last few years, 2023 marked a year of slower than expected progress for the Commission.

Proposed Rulemaking on ESG Disclosures

In 2022, the SEC released for notice and comment two proposed rules geared toward mitigating “greenwashing”—the false or misleading claims by companies and advisers relating to their ESG bona fides or the extent of their products’ or practices’ positive impact on the environment and society.³² Only one of those proposed rules has made it to final form: the “Amended Names Rule.”³³ That new rule expands the Names Rule—which requires that a firm whose name suggests a certain focus invest at least 80 percent of the value of its assets with that focus—to cover funds with names that suggest that their investment decisions incorporate ESG factors.³⁴ The SEC estimates that the Amended Names Rule will increase the number of funds subject to the rule from 60% to 75%.³⁵ The other rule proposed in 2022, a disclosure requirement rule, has not been finalized. That rule would (1) create enhanced disclosure requirements for three categories of registered funds that use ESG factors in investment strategies; and (2) require ESG-focused and ESG-impact funds to include greenhouse gas emissions disclosures associated with their portfolio company investments.³⁶ After numerous delays, the SEC now anticipates that the rule will be finalized in April 2024—more than two years after it was first introduced.³⁷

Recent Enforcement Actions

Since the formation of its Climate and ESG Task Force in 2021, the SEC has made clear that ensuring accurate ESG reporting—required and voluntary alike—is a top priority for the Commission.

In 2023, the SEC achieved its largest ESG related settlement to date.³⁸ The settlement involved the Brazilian mining company Vale S.A., one of the largest iron ore producers in the world. Vale was charged with false and misleading claims about the safety of its dams after one of its dams collapsed in 2019, killing 270 people.³⁹ The SEC alleged that Vale knew that its dam fell below

³⁰ SEC Press Release, SEC Charges LA-Based Media and Entertainment Co. Impact Theory for Unregistered Offering of NFTs (Aug. 28, 2023), <https://www.sec.gov/news/press-release/2023-163>; SEC Press Release, SEC Charges Creator of Stoner Cats Web Series for Unregistered Offering of NFTs (Sept. 13, 2023), <https://www.sec.gov/news/press-release/2023-178>.

³¹ *Id.*

³² See Harris Fischman, SEC Proposed Greenwashing Disclosure Requirements: The Devil Is in the Details (Nov. 1, 2022), LAW.COM, <https://www.law.com/corpcounsel/2022/11/01/sec-proposed-greenwashing-disclosure-requirements-the-devil-is-in-the-details/>

³³ Investment Company Names, Release No. IC-35000 (September 20, 2023), <https://www.sec.gov/files/rules/final/2023/33-11238.pdf>; see also Harvard Law School Forum on Corporate Governance: Seven Key Trends in ESG for 2023—and What to Expect in 2024, <https://corpgov.law.harvard.edu/2024/01/14/seven-key-trends-in-esg-for-2023-and-what-to-expect-in-2024/>.

³⁴ *Id.*

³⁵ Investment Company Names, Release No. IC-35000, n.6 (Sept. 20, 2023), <https://www.sec.gov/files/rules/final/2023/33-11238.pdf>

³⁶ *Id.*

³⁷ Harvard Law School Forum on Corporate Governance: Seven Key Trends in ESG for 2023—and What to Expect in 2024, <https://corpgov.law.harvard.edu/2024/01/14/seven-key-trends-in-esg-for-2023-and-what-to-expect-in-2024/>.

³⁸ *Id.*

³⁹ SEC Press Release, Since 2016, Value Manipulated Safety Audits and Obtained Fraudulent Stability Certificates (Apr. 28, 2022), <https://www.sec.gov/news/press-release/2022-72>.

safety regulations, but that, in its public Sustainability Reports and other public filings, Vale “fraudulently assured investors that the company adhered to the ‘strictest international practices’ in evaluating dam safety and that 100 percent of its dams were certified to be in stable condition.”⁴⁰ The SEC further alleged that Vale manipulated dam safety audits; obtained fraudulent stability certificates; and misled the government, investors and the community using its ESG disclosures.⁴¹ Ultimately, the SEC secured a settlement requiring Vale to pay a \$25 million civil penalty and \$30.9 million of disgorgement and pre-judgment interest.⁴² The settlement indicates the SEC’s willingness to bring actions against allegedly misleading ESG disclosures even where those disclosures are voluntary.⁴³

Furthermore, on September 25, 2023, the SEC announced that it had charged a subsidiary of Deutsche Bank AG in connection with misstatements regarding its ESG investment practices.⁴⁴ The SEC found that the company had “marked itself as a leader in ESG that adhered to specific policies for integrating ESG considerations into its investments.”⁴⁵ In practice, the SEC alleged, the company failed to implement the ESG integration policy as advertised, and failed to adopt policies and procedures to ensure that any public statements regarding such policy were accurate.⁴⁶ The company paid \$19 million in penalties to settle the ESG charge and \$6 million to settle a separate charge for failure to develop an AML program.⁴⁷

In other notable enforcement actions, the SEC brought charges against Activision Blizzard Inc. (“Activision”), a video game development and publishing company, for failing to collect and analyze employee complaints of workplace misconduct, rendering management unable to assess whether the misconduct necessitated public disclosure.⁴⁸ Activision was also charged for violating a whistleblower protection rule that required former employees to notify the company of any requests for information from the Staff.⁴⁹ Activision agreed to a cease-and-desist order and paid a \$35 million penalty.⁵⁰

Other Important Developments in 2023

SPACs

As discussed in our 2022 Year in Review, in March 2022, the SEC proposed significant SPAC-related rulemakings. The SEC adopted the final version of these rules on January 24, 2024. If the new rules come into effect, they would:

- impose new liabilities (including on SPAC underwriters, and de-SPAC targets and their management) in connection with de-SPAC transactions;

⁴⁰ *Id.*

⁴¹ *Id.*

⁴² SEC Press Release, Brazilian Mining Company to Pay \$55.9 Million to Settle Charges Related to Misleading Disclosures Prior to Deadly Dam Collapse (Mar. 28, 2023), <https://www.sec.gov/news/press-release/2023-63>.

⁴³ Andrew Ramonas, SEC Watches All Corporate ESG Claims for Accuract, Official Says, Bloomberg Law (Nov. 8, 2023), https://www.bloomberglaw.com/bloomberglawnews/esg/X70000C000000?bna_news_filter=esg#icite.

⁴⁴ SEC Press Release, Deutsche Bank Subsidiary DWS to Pay \$25 Million for Anti-Money Laundering Violations and Misstatements Regarding ESG Investments (Sept. 25, 2023), <https://www.sec.gov/news/press-release/2023-194>.

⁴⁵ *Id.*

⁴⁶ *Id.*

⁴⁷ *Id.*

⁴⁸ SEC Press Release, Misconduct Violating Whistleblower Protection Rule (Feb. 3, 2023), <https://www.sec.gov/news/press-release/2023-22>.

⁴⁹ *Id.*

⁵⁰ *Id.*

- modify the scope of the safe harbor of the Private Securities Litigation Reform Act of 1995 for forward-looking statements so that projections and other forward-looking information used in de-SPAC registration statements would not be eligible for the safe harbor protections conventionally given to such disclosure outside of the traditional IPO context;
- require enhanced disclosures at the SPAC IPO and de-SPAC stages (including requiring a fairness determination by the SPAC regarding the de-SPAC transaction); and
- create a new, non-exclusive safe harbor from registration under the Investment Company Act of 1940 for SPACs that would accelerate most SPAC timelines.⁵¹

The SEC's adopting of the new SPAC rules follows another quiet year of SPAC-related enforcement activity, stemming from the cooling of the SPAC market since its peak in 2021. However, the SEC did bring and settle SPAC-related charges with two audit firms in 2023.⁵² The more prominent of the two settlements was with Marcum LLP, which, at the height of the SPAC boom, was one of the leading auditors of SPACs. The SEC alleged that Marcum suffered from "systemic quality control failures and violations of audit standards" caused in large part by Marcum's rapid growth of SPAC business over a three-year period.⁵³ The SEC criticized Marcum for failing to maintain its "essential gatekeeping role."⁵⁴ This action is consistent with Chair Gensler's continued statements about the SEC's interest in punishing gatekeepers like "auditors, lawyers, underwriters, and others" whom it believes have abused positions of trust.⁵⁵

Cybersecurity

A recent enforcement action reflects the SEC Enforcement Division's expanding focus on cybersecurity incidents and corresponding disclosures of such incidents. On October 30, 2023, the SEC announced charges against SolarWinds Corporation and its Chief Information Security Officer—the target of a two-year long cyberattack known as "SUNBURST."⁵⁶ SolarWinds designs and sells network monitoring software that companies use to detect and resolve network performance issues, as well as cybersecurity products.⁵⁷ The SEC alleged that SolarWinds defrauded its investors by overstating its cybersecurity practices and by disclosing only hypothetical risks rather than actual, known deficiencies and risks.⁵⁸ Specifically, it alleged that SolarWinds' cybersecurity practices "fell significantly short" of the standards outlined on the company's public website, and that the company made similar false and misleading disclosures in its public filings.⁵⁹ The SEC further alleged that, even after SolarWinds purportedly discovered the SUNBURST attack, it concealed that attack in its disclosures.⁶⁰ In response, SolarWinds "issued a full-

⁵¹ https://www.paulweiss.com/media/3984258/securities_practice_2023_in_review.pdf at 7.

⁵² SEC Press Release, SEC Charges Audit Firm Marcum LLP for Widespread Quality Control Deficiencies (June 21, 2023), <https://www.sec.gov/news/press-release/2023-114>; SEC Press Release, SEC Charges UK Audit Firm, CEO, and Senior Auditor for Failures in Connection with De-SPAC Transaction (Aug. 14, 2023), <https://www.sec.gov/news/press-release/2023-152>.

⁵³ SEC, In the Matter of MARCUP LLP, Release No. 97773, (June 21, 2023), <https://www.sec.gov/files/litigation/admin/2023/34-97773.pdf>.

⁵⁴ *Id.* at 3.

⁵⁵ *Id.* at 3.; SEC Speech, "Partners of Honest Business and Prosecutors of Dishonesty": Remarks Before the 2023 Securities Enforcement Forum (Oct. 25, 2023), <https://www.sec.gov/news/speech/gensler-remarks-securities-enforcement-forum-102523>.

⁵⁶ SEC Press Release, Complaint Alleges Software Company Misled Investors About Its Cybersecurity Practices and Known Risks (Oct. 30, 2023), <https://www.sec.gov/news/press-release/2023-227>.

⁵⁷ Compl. at ¶¶ 35-56, *SEC v. Solarwinds Corp.*, No. 1:23-cv-09518 (S.D.N.Y. Oct. 30, 2023), <https://www.sec.gov/files/litigation/complaints/2023/comp-pr2023-227.pdf>.

⁵⁸ SEC Press Release, Complaint Alleges Software Company Misled Investors About Its Cybersecurity Practices and Known Risks (Oct. 30, 2023), <https://www.sec.gov/news/press-release/2023-227>.

⁵⁹ Compl. at ¶¶ 38-42, 45, 131-38, No. 1:23-cv-09518 (S.D.N.Y. Oct. 30, 2023).

⁶⁰ *Id.* at ¶¶ 175-81.

throated denial of wrongdoing.”⁶¹ More than 20 former high-ranking federal officials and cybersecurity experts filed an amicus brief in support of SolarWinds’ motion to dismiss.⁶² They argue that “public disclosure of vulnerability information, along with information detailing a company’s security posture, can actually damage law enforcement investigations, provide a roadmap to aid threat actors, and make companies less safe.”⁶³ This lawsuit marks the first time the SEC has brought cybersecurity enforcement claims against an individual. It is also the first time the SEC has brought intentional fraud charges in a cybersecurity disclosure case.

Also of note, in July 2023, the SEC approved final rules enhancing and standardizing cyber incident and risk management disclosures.⁶⁴ Specifically, those rules require reporting material cybersecurity incidents on Form 8-K days after the incident.⁶⁵ They also require comprehensive reporting on policies for identifying and managing cybersecurity incidents, as well as management’s role and the board’s oversight in connection with cyber incidents, on Form 10-K.⁶⁶

New and Expansive Theories of Corporate Internal Controls Failures

As discussed above, in February 2023, the SEC settled charges with Activision for conduct concerning its internal system for reporting and resolving workplace complaints. The Activision settlement is noteworthy because it highlights the novel and expansive approach that the SEC took to enforcing Rule 13a-15(a), which requires issuers to implement and maintain controls and procedures “designed to ensure that information required to be disclosed” in SEC filings is (1) timely “recorded, processed, summarized and reported” to the SEC and (2) “accumulated and communicated to the issuer’s management . . . as appropriate to allow timely decisions regarding required disclosure.”⁶⁷ Activision disclosed a risk factor in its Form 10-K and 10-Q filings that said a failure to attract, retain, and motivate key personnel could materially affect the company’s performance.⁶⁸ The SEC did not allege that this disclosure was incomplete or inaccurate, but rather contended that Activision’s disclosure *controls and procedures* were inadequate because they did not have a process “designed to ensure that information related to employee complaints of workplace misconduct would be communicated to Activision Blizzard’s disclosure personnel to allow for timely assessment on its disclosures.”⁶⁹ Further, the SEC did not allege that workplace misconduct was in fact relevant to retention and recruitment efforts, *i.e.*, to the underlying disclosure, let alone that the information was material such that it needed to be disclosed.⁷⁰

⁶¹ Skye Witley, *SolarWinds Seeks Dismissal of ‘Unfounded’ SEC Cybersecurity Suit*, Bloomberg Law, Jan. 26, 2024, <https://news.bloomberglaw.com/privacy-and-data-security/solarwinds-seeks-dismissal-of-unfounded-sec-cybersecurity-suit>.

⁶² Skye Witley, *Ex-US Cyber, Intelligence Leaders Rally Behind SolarWinds*, Feb. 2., 2024, <https://news.bloomberglaw.com/product/blaw/bloomberglawnews/exp/eyJpZCI6IjAwMDAwMThkLTZiZWQtZDI3Yi1hZGRkLTdiZmZkMjM2MDAwMSIsImN0eHQiOiJTTTE5XliwidXVpZCI6Ij95bTgwZTRDQXNvdU0vdk9STIRObmc9PWRTVZVNmNGajNaSjRteEJRFXFpRWc9PSIsInRpbWUwOixNzA3MTM1MjYyOTAxliwic2lnIjoIQ1h6dG9abnpOeTFPRUV4SmxOQk5CN3lVSXBRPSIsInYiOiIxIn0=?source=newsletter&item=document®ion=digest>.

⁶³ *Id.*

⁶⁴ SEC Final Rule, Cybersecurity Risk Management, Strategy, Governance, and Incident Disclosure, Release Nos. 33-11216, 34-97989, <https://www.sec.gov/files/rules/final/2023/33-11216.pdf>.

⁶⁵ *Id.*

⁶⁶ *Id.*

⁶⁷ 17 C.F.R. § 240.13a-15(e).

⁶⁸ SEC, In the Matter of Activision Blizzard, Inc., Release No. 96796, (Feb. 3, 2023), <https://www.sec.gov/files/litigation/admin/2023/34-96796.pdf>.

⁶⁹ *Id.* at 2; see also <https://www.paulweiss.com/practices/litigation/litigation/publications/sec-announces-novel-human-capital-internal-controls-settlement-with-activision-blizzard-inc?id=46041>.

⁷⁰ <https://www.paulweiss.com/practices/litigation/litigation/publications/sec-announces-novel-human-capital-internal-controls-settlement-with-activision-blizzard-inc?id=46041>.

The SEC took similarly aggressive approaches in both the SolarWinds matter and in a November 14, 2023 settlement with Charter Communications Inc., a large telecommunications company.⁷¹ In SolarWinds, the SEC charged SolarWinds with “internal accounting controls” violations based on alleged *cybersecurity* controls failures, which SolarWinds argued is a “wholesale rewriting of the law.”⁷² In Charter, the SEC alleged that Charter failed to “to devise and maintain internal accounting controls that reasonably assured that the company’s stock buybacks were conducted in accordance with management authorizations.”⁷³ Once again, the SEC did not allege an accounting, trading, or disclosure violation, but instead charged the conduct under Section 13(b)(2)(B) of the Exchange Act, which requires reporting companies to maintain a system of internal accounting controls sufficient to ensure “transactions are executed and access to assets is permitted only in accordance with management’s” authorization.⁷⁴

The Activision and Charter actions seemingly signal that the SEC views these and other internal controls rules as new enforcement hooks for cases even where it may not have a sufficient basis to allege an underlying disclosure, trading, or accounting violation.

Insider Trading

The past year saw significant developments in the insider trading space. The SEC’s new Rule 10b5-1 rules, as discussed in our 2022 Year in Review, became effective on February 27, 2023. Those new rules specify the amount of securities to be sold and the pricing and timing parameters of such sales.⁷⁵ The rules also addressed areas where the SEC saw the potential for abusive practices: they imposed mandatory cooling-off periods, eliminated the use of multiple or overlapping 10b5-1 plans, and required significantly more disclosures regarding trading by issuers and insiders.⁷⁶ Less than a week after the SEC amendments came into effect, the SEC, in a parallel action with the Department of Justice, brought its first-ever insider trading case based exclusively on the use of Rule 10b5-1 trading plans.⁷⁷ The SEC alleged that the former Executive Chairman of Ontrak, Inc. contacted a broker to set up a Rule 10b5-1 plan to sell shares of Ontrak after learning that Ontrak was in danger of a major customer terminating its agreement with Ontrak.⁷⁸ The SEC case is stayed pending the conclusion of the parallel criminal proceedings against the Executive Chairman.⁷⁹ This case and the aforementioned rulemaking highlight the SEC’s and Chair Gensler’s increasing scrutiny of 10b5-1 plans.

In another important insider trading development, on November 20, 2023 the District Court for the Northern District of California denied Defendant Matthew Panuwat’s motion for summary judgment on the SEC’s claim that he violated the federal securities laws by improperly engaging in “shadow trading”—i.e., trading in securities of a similarly situated competitor’s shares

⁷¹ SEC, In the Matter of Charter Communications, Inc., Release No. 98923, (Nov. 14, 2023), <https://www.sec.gov/files/litigation/admin/2023/34-98923.pdf>.

⁷² Motion to Dismiss, at 2, *SEC v. Solarwinds Corp.*, No. 1:23-cv-09518 (S.D.N.Y. Oct. 30, 2023) (ECF 46).

⁷³ *Id.* at 2.

⁷⁴ *Id.* at 4.

⁷⁵ Insider Trading Arrangements and Related Disclosures, 17 C.F.R. §§ 229, 232, 240, 249.

⁷⁶ See *SEC Adopts Final Rules Regarding 10b5-1 Trading Plans and Disclosures for Executive Officer Equity Grants and Gifts*, PAUL, WEISS (Dec. 19, 2022), <https://www.paulweiss.com/practices/transactional/capital-markets/publications/sec-adopts-final-rules-regarding-10b5-1-trading-plans-and-disclosures-for-executive-officer-equity-grants-and-gifts?id=45609>.

⁷⁷ SEC Press Release, SEC Charges Ontrak Chairman Terren Peizer With Insider Trading (Mar. 1, 2023), <https://www.sec.gov/news/press-release/2023-42>.

⁷⁸ Complaint at para 5, *SEC v. TERREN S. PEIZER and ACUITAS GROUP HOLDINGS, LLC*, No. 2:23-cv-01511 (C.D. Cal. 2023), <https://www.sec.gov/files/litigation/complaints/2023/comp-pr2023-42.pdf>.

⁷⁹ Order, *SEC v. TERREN S. PEIZER and ACUITAS GROUP HOLDINGS, LLC*, No. 2:23-cv-01511 (C.D. Cal. Apr. 24, 2023).

while in possession of insider information about his own company.⁸⁰ This is a novel case. It is the first time that the SEC has brought an enforcement action alleging that information about one firm could be considered material to investors of another firm because of the two firms' similarities or connections.⁸¹ The court's decision here, along with the decision related to Ontrak discussed above, could embolden or deter the SEC from continuing to pursue aggressive charging theories into trading conduct that historically has not been prohibited.

Investment Professionals and Service Providers

In addition to the charges arising from the recordkeeping sweep discussed above, the SEC has initiated enforcement actions against investment professionals for issues ranging from the failure to disclose conflicts of interest⁸² to misleading the trustees of an exchange-traded fund ("ETF") they managed in order to obtain rescue funds to avoid potential bankruptcy.⁸³ Notably, the SEC has cracked down on individual actors at these firms as well. For instance, in the action involving misleading a trustee, the SEC brought charges against the entity that managed the ETF at issue as well as the founder and CEO of that entity.⁸⁴ The SEC alleged that, in exchange for \$20 million in financing, the CEO agreed to keep an ETF's profitable business at the broker-dealer that provided the financing despite the existence of better deals.⁸⁵ The CEO failed to disclose his arrangement and even denied that other deals were on the table.⁸⁶ Ultimately, he agreed to a cease-and-desist order, paid a \$400,000 penalty, and was subject to an associational bar under the Advisers Act and a prohibition under the Company Act, with the option to reapply in the future.⁸⁷

Uncertainty Around SEC's Continued Use of Administrative Courts in Certain Proceedings

In our 2022 Year in Review, we reported on *Jarkesy v. Securities and Exchange Commission*, in which the Fifth Circuit held that the SEC's use of an administrative law judge ("ALJ") to preside over civil fraud claims brought under the Exchange act was unconstitutional.⁸⁸ We opined that *Jarkesy* had the potential to undermine the SEC's ability to use administrative courts to litigate disputes.

We also previewed another case that could impact the SEC's use of administrative courts: *Securities Exchange Commission v. Cochran*.⁸⁹ That case centers upon questions of when and where constitutional objections to agency power may be pursued.⁹⁰ Specifically, it involved a plaintiff who attempted to sidestep a statutory scheme under which a party who objects to the SEC's proceedings first files its claims within the Commission and then, if necessary, in a federal court of appeals.⁹¹ Instead, the

⁸⁰ <https://www.paulweiss.com/practices/litigation/securities-litigation/publications/federal-court-denies-defendant-s-summary-judgment-motion-in-sec-shadow-trading-case?id=49328>.

⁸¹ *Id.*

⁸² SEC Press Release, SEC Charges California Advisory Firm AssetMark for Failing to Disclose Multiple Financial Conflicts (Sept. 26, 2023), <https://www.sec.gov/news/press-release/2023-199>.

⁸³ SEC Press Release, SEC Charges New Jersey-Based ETF Manager for Fraudulent Conduct and Bars Founder (Aug. 1, 2023), <https://www.sec.gov/news/press-release/2023-144>.

⁸⁴ *Id.*

⁸⁵ *Id.*

⁸⁶ *Id.*

⁸⁷ *Id.*

⁸⁸ *Jarkesy v. Sec. & Exch. Comm'n*, 34 F.4th 446 (5th Cir. 2022).

⁸⁹ *SEC v. Cochran*, 20 F.4th 194 (5th Cir. 2021).

⁹⁰ *Id.*

⁹¹ *Axon Enterprise, Inc. v. Federal Trade Commission*, 598 U.S. 175, 180 (2023).

plaintiff first brought her claim challenging the constitutionality of ALJ's tenure protections to the district court.⁹² The district court dismissed for lack of jurisdiction, holding that the review scheme in the Securities Exchange Act divested it of jurisdiction over challenges to SEC proceedings, including constitutional claims.⁹³ The case was consolidated with *Axon Enterprise, Inc. v. FTC*, 986 F.3d 1173 (9th Cir. 2021), and the Supreme Court heard oral argument in November 2022. On April 14, 2023, the Court issued its opinion. It reversed, holding that the statutory review scheme outlined in the Securities Exchange Act does not preclude a district court from exercising federal questions jurisdiction over challenges to agency action.⁹⁴ In the wake of both *Cochran* and *Axon Enterprise, Inc.*, it is far from certain that the SEC will be able to keep its cases in administrative courts.

Until the core issue of whether fraud and analogous claims can constitutionally be tried before an administrative law judge is decided, it would be a high-risk strategy for the SEC to pursue contested claims in administrative courts.

* * *

We look forward to providing you with further updates on these and other developments throughout the year ahead.

⁹² *Id.* at 183-84.

⁹³ *Id.*

⁹⁴ *Id.* at 195-96.

This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

Walter Brown
+1-628-432-5111
wbrown@paulweiss.com

John P. Carlin
+1-202-223-7372
jcarlin@paulweiss.com

Harris Fischman
+1-212-373-3306
hfischman@paulweiss.com

Joshua Hill Jr.
+1-628-432-5123
jhill@paulweiss.com

Loretta E. Lynch
+1-212-373-3118

Staci Yablon
+1-212-373-3396
syablon@paulweiss.com

Susanna M. Buerger
+1-212-373-3553
sbuerger@paulweiss.com

Andrew J. Ehrlich
+1-212-373-3166
aehrich@paulweiss.com

Michael E. Gertzman
+1-212-373-3281
mgertzman@paulweiss.com

Brad S. Karp
+1-212-373-3316
bkarp@paulweiss.com

Lorin L. Reisner
+1-212-373-3250
lreisner@paulweiss.com

David K. Kessler
+1-212-373-3614
dkessler@paulweiss.com

Jessica S. Carey
+1-212-373-3566
jcarey@paulweiss.com

Roberto Finzi
+1-212-373-3311
rfinzi@paulweiss.com

Melinda Haag
+1-628-432-5110
mhaag@paulweiss.com

Gregory F. Laufer
+1-212-373-3441
name.name@paulweiss.com

Theodore V. Wells, Jr.
+1-212-373-3089
twells@paulweiss.com

Associates Kevin P. Madden and Emily G. Sasso contributed to this Client Memorandum.