

May 1, 2020

## **SEC Charges Company with COVID-19-Related Securities Fraud, Reaffirming its Focus on Public Statements and Disclosures Relating to COVID-19**

The SEC has, in recent weeks, made highly publicized pronouncements about pursuing enforcement actions arising out of the COVID-19 pandemic. Earlier this week, with remarkable speed, the SEC filed what appears to be its first enforcement action arising out of the COVID-19 pandemic. The complaint alleges that a Florida-based company (Praxsyn Corp.) and its CEO misled investors by falsely stating in various press releases that the company was able to acquire and supply large quantities of N95 or similar masks, when in fact the company never had any masks in its possession, had received no mask orders, and did not have a single contract with any manufacturer or supplier to obtain masks.<sup>1</sup> In its press release, the SEC stated that it “will move swiftly against those who seek to profit off this national emergency by cheating or misleading investors.”<sup>2</sup>

These charges follow a series of public statements by the Chairman of the SEC and other senior members of the SEC staff regarding public company responses to the pandemic and resulting mitigation efforts. Chairman Jay Clayton asked the staff to “monitor” disclosures related to the pandemic as early as January 29,<sup>3</sup> and reminded companies in early March that their responses to the pandemic “can be material to an investment decision.”<sup>4</sup> In advance of upcoming earnings releases and investor calls, Chairman Clayton and the Director of the Division of Corporation Finance William Hinman advised companies that their disclosures should address: “(1) where the company stands today, operationally and financially, (2) how the company’s COVID-19 response, including its efforts to protect the health and well-being of its workforce and its customers, is progressing, and (3) how its operations and financial condition may change as all our efforts to fight COVID-19 progress.”<sup>5</sup> More recently, the SEC formed a temporary, cross-divisional COVID-19 Market Monitoring Group.<sup>6</sup> Notably, the SEC also has suspended trading for at least 20 publicly traded

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<sup>1</sup> <https://www.sec.gov/litigation/complaints/2020/comp-pr2020-97.pdf>.

<sup>2</sup> <https://www.sec.gov/news/press-release/2020-97>.

<sup>3</sup> <https://www.sec.gov/news/public-statement/clayton-mds-2020-01-30>.

<sup>4</sup> <https://www.sec.gov/news/press-release/2020-53>.

<sup>5</sup> <https://www.sec.gov/news/public-statement/statement-clayton-hinman>.

<sup>6</sup> <https://www.sec.gov/news/press-release/2020-95>.

stocks in connection with the COVID-19 pandemic—including the defendant in this case<sup>7</sup>—nearly all of which were over-the-counter penny stocks.

The filing of the fraud charges against Praxsxn Corp. and its CEO and the SEC staff's consistent guidance over the last several months confirm that the SEC remains laser-focused on companies' public statements about the COVID-19 pandemic. As we have previously noted, companies should consider whether they have provided an appropriate level of transparency about the actual and potential impact of COVID-19 and related mitigation efforts in their public disclosures—including their risk factors, in their MD&A and their financial guidance (if any). Our full memo on withdrawing or revising earning guidance can be found [here](#).

Additionally, the SEC Enforcement Co-Directors have specifically advised companies and their insiders to comply with prohibitions on insider trading in light of the increased likelihood that reporting company insiders could be in possession of material nonpublic information due to the COVID-19 pandemic.<sup>8</sup> As we previously noted, companies should revisit and closely adhere to corporate controls and procedures around material nonpublic information, and consider whether it might be appropriate to temporarily prohibit stock purchases or sales by corporate officers and directors. Our full memo on insider trading and selective disclosure risks related to COVID-19 can be found [here](#).

Finally, as noted in our series of memoranda on mitigating securities litigation risks related to COVID-19, available [here](#) and [here](#), we expect that the plaintiffs' securities bar will also be carefully scrutinizing companies' disclosures in their periodic reports and separate public statements about the effects of COVID-19 on their businesses and operations, which could result in class-wide fraud claims and shareholder derivative claims. In fact, several new COVID-19-related securities cases have been filed since our last update in late March, including a securities fraud class action lawsuit against a telecommunications company relating to alleged privacy and security weaknesses,<sup>9</sup> the first pandemic-related shareholder derivative lawsuit against a pharmaceutical company and its directors relating to statements about the company's development of a COVID-19 vaccine,<sup>10</sup> and the first pandemic-related lawsuit alleging violations of the Securities Act of 1933 by a Chinese real estate company in its January 2020 IPO.<sup>11</sup> We expect this trend to continue as the pandemic continues to drive market volatility.

We will continue to closely monitor the legal and business implications associated with the COVID-19 pandemic and report on further developments in both civil litigation and regulatory action.

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<sup>7</sup> <https://www.sec.gov/litigation/suspensions/2020/34-88479-o.pdf>.

<sup>8</sup> <https://www.sec.gov/news/public-statement/statement-enforcement-co-directors-market-integrity>.

<sup>9</sup> See *Drieu v. Zoom Video Communications, Inc., et al.*, No. 20-cv-2353 (N.D. Cal.).

<sup>10</sup> See *Beheshti v. Kim, et al.*, No. 20-cv-1962 (E.D. Pa.).

<sup>11</sup> See *Wandel v. Gao, et al.*, No. 20-cv-3259 (S.D.N.Y.).

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:

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