

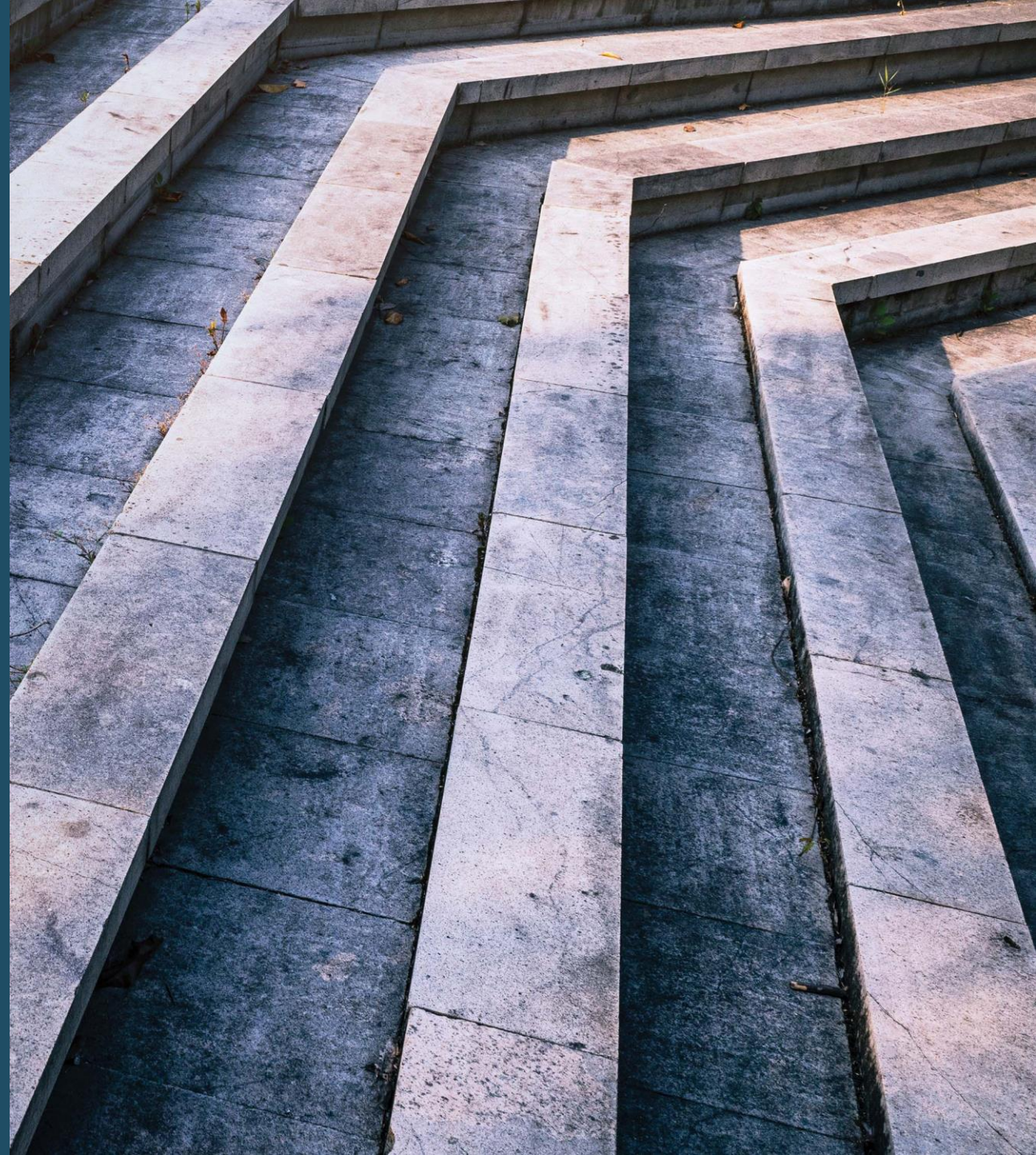
Vinson&Elkins

Navigating

Inside the SEC

Rebecca Fike

January 26, 2023



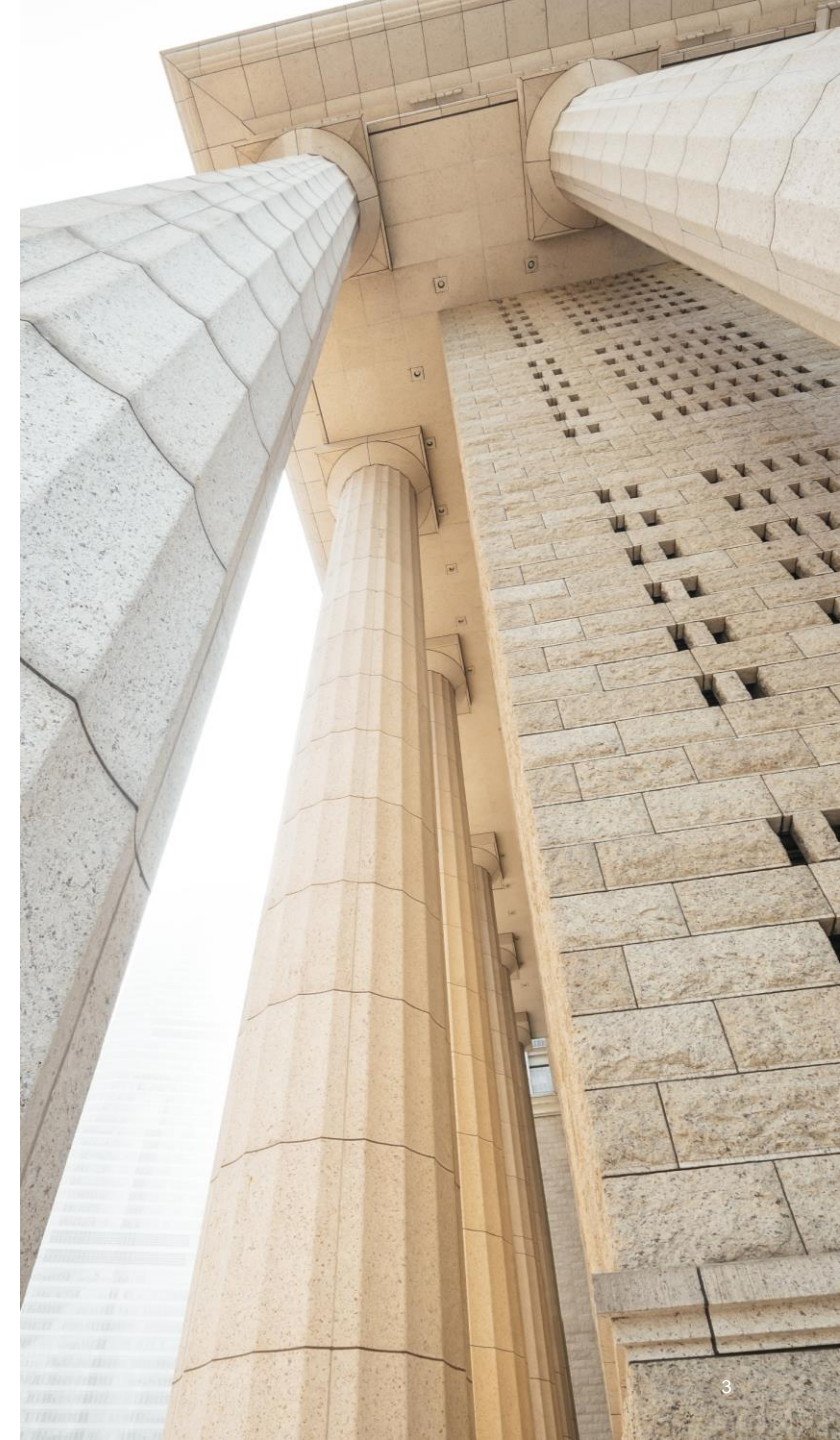
Agenda

- **Shifts in Enforcement Priorities:**
 - Focus on Disclosures
 - Ephemeral Messaging
 - False and Misleading Statements on Social Media
 - SOX 304 Clawbacks – Enforcement
- **New Rules & Enforcement Theories:**
 - Rulemaking: Proposed Amendments to the Names Rule *and* SOX 304 Clawbacks – Rulemaking – Final Clawback Rule (Issuers and Exchanges)
 - Enforcement Theories: Shadow Trading
- **SEC Updates Outside the SEC:**
 - *Jarkesy v. SEC* (5th Cir.)
 - PCAOB Budget
- **Questions?**

Shifts in Enforcement Priorities: Focus on Disclosures

In re Stephen J. Easterbrook & McDonalds Corp., Securities Act Release No. 11144, Exchange Act Release No. 96610, 2023 WL 143292 (Jan. 9, 2023)

- Former CEO, Easterbrook is terminated “without cause,” allowing him to retain equity compensation totaling approximately \$44 million, after he engaged in inappropriate relationship with a single employee
 - Later discovered that Easterbrook engaged in inappropriate relationships with *multiple* employees
-
- SEC found that Easterbrook violated anti-fraud provisions of the Securities Act of 1933 and Securities Exchange Act of 1944 by:
 - Withholding information about other inappropriate relationships during internal investigation to increase probability that his termination would be without cause
 - SEC found that McDonalds violated Section 14(a) of the Exchange Act and Exchange Act Rule 14a-3 by:
 - Filing definitive proxy statement and seeking shareholder approval of 2019 executive compensation, which included Easterbrook’s compensation, without disclosing that it “exercised discretion” in choosing to terminate Easterbrook without cause
 - “Public issuers . . . are required to disclose and explain *all material elements* of their CEO’s compensation, including factors regarding any separation agreements”



Shifts in Enforcement Priorities: Focus on Disclosures (TLDR)

The SEC has a public service announcement:



Shifts in Enforcement Priorities: Ephemeral Messaging

General Trend in 2023→ “G” for Governance

- Accounting Practices, Corporate Transparency, Record-keeping, etc.

Firms Use of Ephemeral Messaging Technology (e.g., WhatsApp, Signal) violated Rules 17a-4 and 17a-4(b)(4) of the Exchange Act

Recordkeeping is “an integral part” of enforcement

Fines totaled **\$1.16 billion**

Shifts in Enforcement Priorities: Statements on Social Media

- Order Denying Motion to Dismiss, *SEC v. Trevor J. Milton* (S.D.N.Y.)
 - Former CEO of Nikola, Corp., an electric-and hydrogen-powered vehicle and energy company
 - Misleading statements on Twitter, Instagram, and Podcasts
- Order Regarding Motion for Penny Stock Bar, *SEC v. Andrew L. Fassari* (C.D. Cal.)
 - Self-described “Master short squeeze artist” and “#Pennystock Wizard”
 - Misleading statements on Twitter
- Complaint *SEC v. Theodore J. Farnsworth, J. Mitchell Lowe, & Khalid Itum* (S.D.N.Y.)
 - MoviePass → statements about stability and feasibility of \$9.99/month pricing model
 - Misleading statements on Online Media and Podcasts

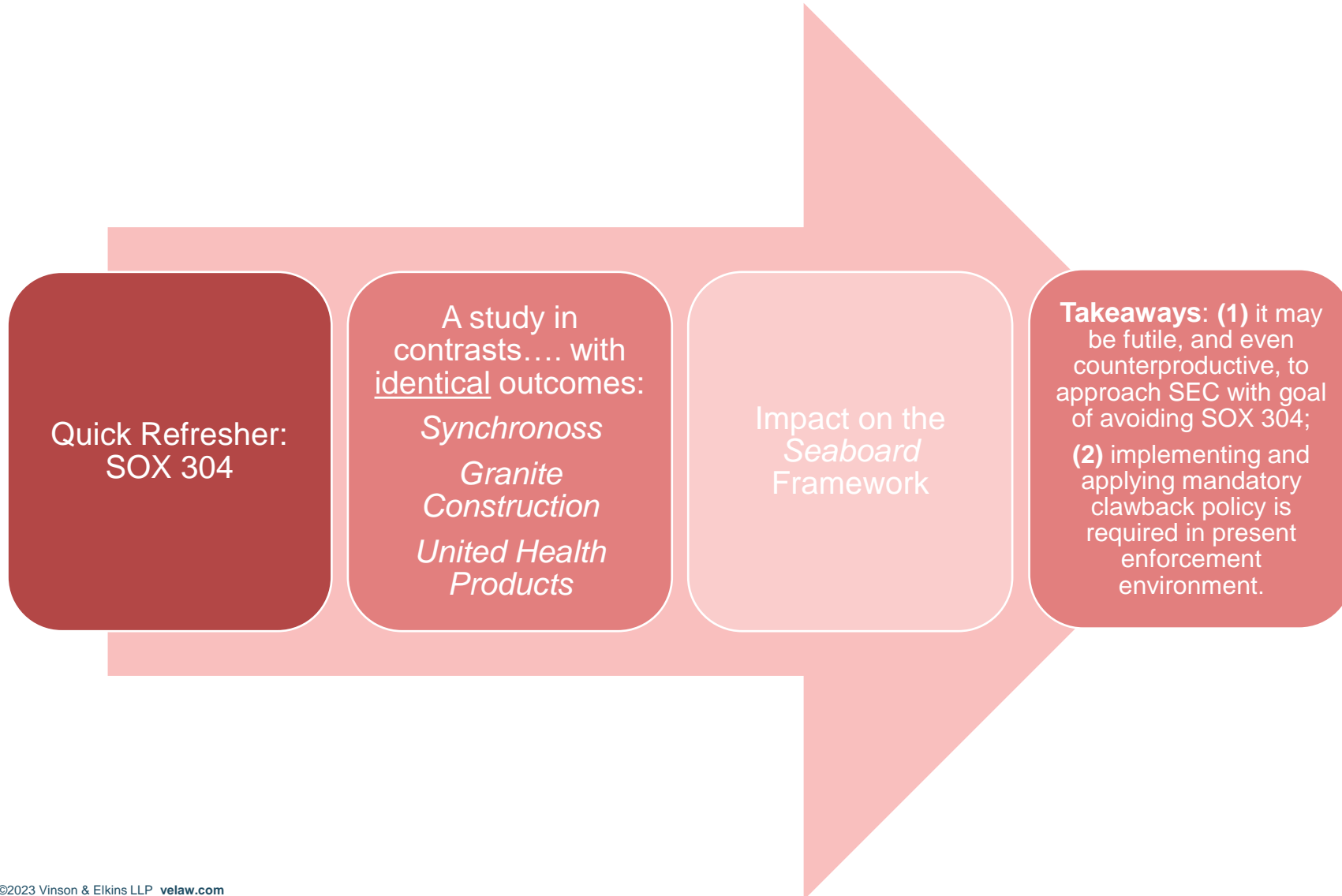
#Pennystock Wizard tweets lies to inflate price of penny stocks and dumps them for profit

#SEC *takes notice*

#Pennystock Wizard:



Shifts in Enforcement Priorities: SOX 304 Clawbacks



New Rules & Enforcement Theories: Proposed Amendments to the Names Rule

- Names Rule targets “materially deceptive and misleading [fund] name[s].”
 - Prohibits names suggesting fund focuses on “certain investments or industries,” “certain countries or geographic regions,” or has “[t]ax-exempt” status, unless name accurately reflects “at least 80%” of asset value → **80% Rule**.
- SEC recently reopened comment period for proposed amendments to Names Rule. Highlights include:
 - Fund names with ESG and similar terminology are subject to 80% Rule
 - SEC considering whether names of “integration funds” should be deemed categorically misleading or deceptive if fund names indicate they incorporate one or more ESG factors
 - SEC considering whether fund’s investment policy must address each element in fund name that suggests an investment focus
 - *i.e.*, fund named “XYZ ESG Fund” may be required to adopt 80% investment policy that addresses *each* element.

New Rules & Enforcement Theories: Final Clawback Rule (Issuers and Exchanges)

- Section 10D(b) of Exchange Act → mandatory clawbacks should be triggered only when erroneous award results from company's "material noncompliance" with financial reporting rules
- Difference between "Big R" and "little r" accounting restatements disregarded
 - Critics say SEC has thus strained meaning of materiality to its limits, in "**conflict with [Congress's] statutory directive**"
- Final clawback rule mirrors SEC's aggressive approach to SOX 304 enforcement → requires mandatory recovery of "any incentive-based compensation that may be impacted by financial reporting"
- Senate Banking Committee → Section 10D(b) authorizes rulemaking requiring mandatory recovery from only "a very limited number of employees"
 - But final clawback rule defines "executive officer" to include, among others, "any other officer who performs a policy-making function"

New Rules & Enforcement Theories: Shadow Trading

- Order Denying Motion to Dismiss, *SEC v. Matthew Panuwat* (N.D. Cal.)
- SEC alleged that Panuwat, a pharmaceutical executive at Medivation Inc., engaged in insider trading by using confidential information about Medivation's imminent acquisition by Pfizer, Inc. to purchase options for the securities of ***another company***
- Court denied Panuwat's motion to dismiss, notwithstanding unprecedented nature of SEC's "shadow trading" theory.
- No major updates to Panuwat docket (3:21-cv-06322) and apparently no new shadow trading cases.



SEC Updates Outside the SEC: *SEC v. Jarkesy* (5th Cir.)

SEC brought administrative action against George R. Jarkesy, Jr. and Patriot28, L.L.C. for securities fraud. ALJ ordered various sanctions. Defendants appealed to Fifth Circuit with several constitutional arguments.

Fifth Circuit vacated and remanded, because:

1. Petitioners were deprived of Seventh Amendment right to jury trial;
2. Congress's failure to provide intelligible principle to guide SEC in selecting forum for certain actions violates non-delegation doctrine; and
3. The two layers of "for cause" removal protection for ALJs violate Take Care Clause of Article II

- October 21, 2022: Fifth Circuit declined to rehear *Jarkesy* en banc
- January 6, 2023: SCOTUS extended deadline for U.S. Solicitor General to file petition to February 17
- Impact of *Jarkesy*? Sixth Circuit declined to follow → *Calcutt* v. FDIC (6th Cir.)


SEC Updates Outside the SEC: PCAOB Budget

- The PCAOB has requested \$349.5 million for its 2023 budget and \$329.45 million for its 2023 “accounting support fee.”
- Criticisms about the PCAOB’s “[b]allooning” budget recall conversations during the prior administration about merging the PCAOB and SEC.


Year	Budget (Total Outlays)	%	Accounting Support Fees	%
2004	\$103,297,000	--	\$101,247,000	--
2005	\$137,118,000	32.74%	\$136,110,000	34.43%
2006	\$130,944,000	-4.50%	\$109,307,000	-19.69%
2007	\$136,430,000	4.19%	\$122,362,000	11.94%
2008	\$144,607,000	5.99%	\$134,511,000	9.93%
2009	\$157,608,000	8.99%	\$151,757,000	12.82%
2010	\$183,258,000	16.27%	\$178,066,000	17.34%
2011	\$204,381,000	11.53%	\$202,340,000	13.63%
2012	\$227,708,000	11.41%	\$214,983,000	6.25%
2013	\$245,616,754	7.86%	\$234,008,000	8.85%
2014	\$258,414,485	5.21%	\$252,028,501	7.70%
2015	\$250,881,960	-2.91%	\$226,553,834	-10.11%
2016	\$257,717,287	2.72%	\$253,289,437	11.80%
2017	\$268,531,748	4.20%	\$267,964,826	5.79%
2018	\$259,908,545	-3.21%	\$235,322,853	-12.18%
2019	\$273,740,984	5.32%	\$262,851,931	11.70%
2020	\$284,712,000	4.01%	\$270,163,000	2.78%
2021	\$287,279,000	0.90%	\$263,919,000	-2.31%
2022	\$310,285,000	8.01%	\$297,922,000	12.88%
2023	\$349,531,000	12.65%	\$329,408,000	10.57%

Questions?


THANK YOU




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