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Featured Topics

Introduction

After issuing a flurry of rule-making proposals in the first quarter of 2022, SEC Chair Gensler appeared before Congress to advocate for additional personnel he believes necessary to keep pace with the SEC's sweeping regulatory and enforcement mandate. For his part, Director Grewal, at an industry conference, expressed his concerns with the pace of the enforcement investigations and his frustration with the conduct of defense counsel delaying and/or inhibiting SEC investigations. This edition of Schulte Roth & Zabel's *Securities Enforcement Quarterly* details these remarks and also focuses on the DOJ's use of the wire fraud statute to prosecute insider trading in NFTs, and discusses a recent decision by the Fifth Circuit U.S. Court of Appeals that outlaws the SEC from initiating enforcement proceedings before its internal panel of administrative law judges. This edition also describes the intersection of the SEC's newly proposed SPAC rules with recent enforcement cases in the area, and finally, summarizes this quarter's significant enforcement actions.

SEC Leadership: An Ambitious Agenda

As expected, during the first half of 2022, the SEC has pursued an ambitious rule-making and enforcement agenda not seen since the aftermath of the 2008 financial crisis. Moreover, as detailed below, recent statements by Chair Gensler and other senior SEC officials delivered the clear message that a reinvigorated SEC is just getting started and there's much more to come.

Follow the Money

In May, Chair Gensler testified before Congress about the SEC's 2023 budget and requested more resources. He emphasized the SEC's role in maintaining the U.S. financial markets as the "gold standard" for capital markets throughout the world.[1] Chair Gensler stressed the importance of an "adequately resourced" SEC, noting that the SEC has shrunk even as the U.S. capital markets have grown in recent years. His testimony cited examples of this dramatic growth: during the past five years, the number of registered entities the SEC oversees has increased by 12 percent, to 29,000; the number of private funds managed by registered investment advisers has increased 40 percent, to 50,000; and the amount of data that the SEC processes has grown by 20 percent annually in each of the last two years. Chair Gensler observed that compared to the dramatic growth of the markets and the number of SEC registrants during the last five years, the SEC has failed to keep pace. The SEC employs fewer staff now than it did five years ago, and its current budget request reflects a 33 percent increase over its FY2016 budget. The $2.15 billion budget request reflects an eight percent increase over FY21, and seeks to add 400 new staff positions. More than half of the new positions will be in the Divisions of Enforcement and Examinations, which together comprise roughly one-half of the SEC's personnel.[2]

The new Enforcement positions are intended to strengthen the SEC's ability to investigate emerging issues such as digital assets, cyber-related risk and ESG disclosures, and to address an expected rise in the number of litigated cases. Chair Gensler noted that these additional resources are also needed to keep pace with increased whistleblower tips. Additional staff in the Division of Examinations will enable the staff to keep pace with its examination program in light of the increasing number of private funds and broker-dealers. In recent years the SEC has increased the volume of examinations, due in part to conducting virtual exams during the pandemic, and more staff are needed for on-site examinations. The bulk of the 90 new Examination positions will be dedicated to oversight and exam activities, including 34 for investment advisers, 25 for broker-dealers and Regulation Best Interest, 20 for new swap market registrants and five for cybersecurity and market infrastructure.

Finally, over the past five years the SEC's Division of Investment Management has overseen 50 percent growth (from $67 trillion to $100 trillion) in combined assets under management in registered investment companies, private funds, and separately managed accounts. Chair Gensler's testimony underscored the dramatic growth of the industry over the last five years: 25 percent increase in the number of registered investment advisers; 70 percent increase in the number of clients for RIAs; 100 percent increase in ETF assets under management; and 75 percent increase in assets managed by advisers to private funds, including private equity and venture capital funds. In response to this growth, the SEC seeks authorization for 13 additional positions in the Division of Investment Management.[3]

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[1] Gary Gensler, *Testimony at Hearing before the Subcommittee on Financial Services and General Government U.S. House Appropriations Committee*, May 17, 2022, available here.

[2] SEC, *SEC Fiscal Year 2023 Congressional Budget Justification Annual Performance Plan, March 25, 2022,* available here.

[3] *Id.* at 6.

Evolving SEC Enforcement Process

In May, Director of Enforcement Gurbir Grewal made news with an industry conference speech during which he expressed concern that conduct by some defense counsel was slowing the pace of SEC investigations.[4] Director Grewal observed that he respects the role that defense counsel play in representing their clients before the SEC, but cautioned that "dilatory and obstructive conduct is not zealous advocacy." Rather, such behavior "frustrates the SEC's processes [and] puts investors at risk" according to Director Grewal. He warned that "gamesmanship" designed to delay investigations may be contributing to erosion of the public's trust in the markets and in government more generally, making it difficult in some instances for the SEC to take quick action in response to apparent misconduct.

Director Grewal's comments addressed concerns with three aspects of SEC investigations: document production, on-the-record testimony and assertions of attorney-client privilege. Regarding document productions, Director Grewal noted that the Enforcement Division often observes repeatedly missed production deadlines, production of voluminous yet irrelevant material and very slow or "trickling" rolling productions as conduct seemingly intended to thwart SEC investigations. Regarding testimony, Director Grewal highlighted examples of potentially obstructive behavior, such as counsel repeatedly making inapplicable objections that disrupt testimony; speaking over the witness in response to questions; and coaching witnesses overtly about how and whether to answer staff questions. Regarding privilege assertions, Director Grewal acknowledged the "collective interest that clients seek counsel and make informed, well-guided business decisions," yet he bemoaned questionable privilege assertions, including instances where a lawyer happened to be present for interactions in which no legal advice was requested or provided.

Director Grewal also discussed his view of "the way forward" for investigations. He emphasized the "tangible benefits" — reduced penalties or even no penalties — for clients who proactively cooperate during SEC investigations. As to what constitutes credit-worthy cooperation, Director Grewal noted that it requires "affirmative behavior," such as self-reporting and remediation, not merely "the absence of obstruction." Examples of cooperation that Director Grewal identified include: making documents and witnesses available to the SEC on an expedited basis; highlighting or explaining "hot" documents (even if outside the scope of the SEC subpoena); and making presentations that transcend advocacy to "meaningfully illuminate" relevant facts. Director Grewal concluded his remarks by pledging that Enforcement staff would not play games during investigations, negotiations or litigations. According to Director Grewal, the SEC does not threaten potential charges or demand admissions merely to obtain leverage. Rather, settlement offers are calibrated to the case and the conduct and reflect "rigorous thought" about the appropriate result.

Without debating Director Grewal's observations regarding counsel/SEC staff interactions during investigations, his comments provide useful insights about his view of the enforcement process. As he made clear, Enforcement officials are monitoring the pace of investigations and expect them to move forward. When the SEC perceives that an investigation is proceeding more slowly than expected due to conduct by counsel or their client, the staff will respond quickly and forcefully. The SEC is prepared to reward affirmative cooperation, particularly where it saves staff resources and streamlines complex investigations. And finally, proposed charges and settlement demands by the SEC are not tactical, but are intended to be principled based on the SEC's view of the underlying conduct.

[4] Gurbir S. Grewal, *Remarks at Securities Enforcement Forum West 2022*, May 12, 2022, available here.

Private Funds in Focus

Earlier this year, the SEC announced that strategic and more comprehensive oversight of private investment funds by the Division of Examination is one of its top 2022 examination priorities.[5] As discussed in our prior *Alert* available here, the 2022 priorities report from the Division of Examinations noted the SEC's focus on advisers to private funds, especially concerning fees and expenses.[6] Other focus areas include compliance with fiduciary duties, custody rule, conflicts, valuation and risks and controls concerning material nonpublic information. Beyond these issues, SEC Examinations will focus on emerging areas such as ESG disclosures, digital assets and the use of developing financial technologies, including alternative data research products.

[5] SEC, *2022 Examination Priorities Report*, Division of Examinations, available here.

[6] Schulte, Roth & Zabel, LLP, *SEC Examinations: What Private Fund Managers Can Expect in 2022* (April 19, 2022), available here.

First Digital Asset Insider Trading Case Highlights Expanded Use of Traditional Fraud Charges to Target Non-Traditional Insider Trading

Last summer, we wrote about *United States v. Blaszczak* and federal prosecutors' use of non-securities law fraud theories to combat insider trading.[7] As we noted before, no federal criminal statute on the books specifically outlaws insider trading. Traditionally, prosecutors rely on the securities law anti-fraud prohibition in Section 10(b) of the Securities Exchange Act and Rule 10b-5 promulgated thereunder. But when fraudulent trading activity does not neatly fit into the rubric of Section 10(b) and Rule 10b-5, prosecutors turn to a variety of other federal statutes to address the misconduct. This quarter, the use of non-securities laws to pursue allegations of insider trading is making headlines. On June 1, 2022, the Department of Justice ("DOJ") charged Nathaniel Chastain ("Chastain"), a former product manager at Ozone Networks, Inc. d/b/a OpenSea ("OpenSea"), with wire fraud and money laundering — not securities fraud — for his alleged insider trading of a form of unique digital asset known as "Non-Fungible Tokens" or NFTs.[8]

The charges against Chastain are particularly noteworthy as they come in the midst of heated debate among various federal regulators over how best to regulate digital assets and their exchanges, made even more urgent by the recent declines in the cryptocurrency market. Nearly a year ago, SEC Chair Gary Gensler observed that the digital asset space "is rife with fraud, scams, and abuse."[9] Chair Gensler recently expressed his belief that most digital assets fall under the Commission's regulatory jurisdiction, and that he's concerned digital asset exchanges are "trading against their customers often because they're market-making against their customers."[10] Nevertheless, there remains no definitive rulemaking or guidance regarding regulation of digital assets and their exchanges, inviting prosecutors to rely on non-Section 10(b) theories of insider trading liability.

How Insider Trading Liability Extends Beyond Section 10(b)

Civil and criminal insider trading charges are traditionally grounded in Section 10(b) and Rule 10b-5 thereunder, which prohibit any person from directly or indirectly using any measure to defraud others, making false or misleading material statements or engaging in any other fraudulent or deceitful business practice in connection with the purchase or sale of securities.[11] In order for any individual to be charged with insider trading under Section 10(b) and Rule 10b-5, the individual *must have traded in a security*. 15 U.S.C. § 78j. Accordingly, the lack of any definitive answer as to whether NFTs or other similar digital assets are "securities," significantly hampers use of traditional insider trading liability theories for alleged misconduct in the sale or purchase of digital assets.

The much broader elements of the criminal wire fraud statute, 18 U.S.C. § 1343 ("Section 1343"), however, require *only* a finding that: (1) an individual knowingly devised or engaged in a scheme to defraud others by using false or fraudulent pretenses, representations or promises about a material fact; (2) the individual had the intent to defraud; and (3) the individual made use of interstate wire communications (*i.e.*, wire, radio, telephonic, electronic, digital, etc.) in order to further or carry out any part of the scheme. Moreover, simply having a *scheme* to defraud is enough

[7] For further discussion, see *SRZ Securities Enforcement Quarterly*, July 2021, available here.

[8] Indictment, *United States v. Chastain,* No. 22-cr-305 (S.D.N.Y. June 1, 2022), available here.

[9] Gary Gensler, *Remarks Before the Aspen Security Forum*, Aug. 3, 2021, available here.

[10] Allyson Versprille and Olga Kharif, *SEC's Gensler Says Crypto Exchanges Trading Against Clients*, Bloomberg, May 10, 2021, available here.

[11] 12 CFR §240.10b-5.

to meet the elements of the criminal wire fraud statute, meaning the scheme can fail, and no actual fraud or loss to victims is required in order to prosecute fraud under Section 1343.[12] Charging insider trading of digital assets as wire fraud, therefore, relieves prosecutors from having to meet all of the elements of Section 10(b) and Rule 10b-5, including that the: (1) conduct at issue involves the sale or purchase of a security; (2) information misused was material; and (3) defendant personally benefitted.

For example, when the DOJ could not meet the "personal benefit" prong of Section 10(b) and Rule 10b-5, the DOJ successfully obtained an insider trading conviction under Section 1343 in *United States v. Blaszczak*.[13] The *Blaszczak* matter concerned the misappropriation of a government agency's confidential, nonpublic information in connection with trading of related securities. In that case, the defendants were charged with securities fraud under Section 10(b), and other forms of fraud including wire fraud under Section 1343. Ultimately the defendants were acquitted on the securities fraud charges — as noted, this was likely due to an absence of proof, as required in a Section 10(b) insider trading case, that the defendants had received a "personal benefit," in the form of money or otherwise, in exchange for sharing the misappropriated data. Nevertheless, the defendants were convicted of, *inter alia*, Section 1343 wire fraud. [14]

On appeal, the Second Circuit held that insider trading theories of liability are not cabined solely to Section 10(b). In the case of *Blaszczak*, the term "defraud" in Section 1343 need not be construed to have the same meaning as in Section 10(b) and Rule 10b-5 and the personal-benefit test does not apply to Section 1343 insider trading cases, easing the ability for the government to prosecute insider trading cases without having to meet all of the elements of Section 10(b). [15] The Supreme Court has since remanded *Blaszczak* back to the Second Circuit for rehearing on issues unrelated to the "personal benefit" question. [16]

United States v. Chastain

The indictment alleges that, as product manager, Chastain participated in the selection of NFTs featured on OpenSea, an online marketplace for the purchase and sale of crypto collectibles.[17] The value of these featured NFTs, as well as other NFTs by the same creators, typically increased after being highlighted on OpenSea.[18] OpenSea considered the selection of featured NFTs as confidential, nonpublic business information.[19] Despite knowing the information was OpenSea's nonpublic, confidential information, the indictment alleges that Chastain was illegally front-running the announcement by OpenSea that certain NFTs would be featured on its platform. Chastain conducted the alleged unlawful trading using anonymous OpenSea accounts, and transferred funds through multiple anonymous Ethereum accounts in order to further conceal his unlawful trading.

Between June 2021 and September 2021, Chastain allegedly bought and sold approximately 45 NFTs while in possession of confidential information that he had misappropriated from his employer, typically selling the NFTs at

[12] *See United States* v. Pollack, 534 F.2d 964, 971 (D.C. Cir. 1976), *cert. denied*, 429 U.S. 924 (1976).

[13] For further discussion, see *SRZ Securities Enforcement Quarterly*, July 2021, available here.

[14] *United States v. Blaszczak*, 947 F.3d 19, 26 (2d Cir. 2019), cert. granted, judgment vacated sub nom. *Olan v. United States*, 141 S. Ct. 1040 (2021), and cert. granted, judgment vacated, 141 S. Ct. 1040 (2021).

[15] *Id.* at 35.

[16] 141 S. Ct. 1040.

[17] Indictment at 4.

[18] *Id.*

[19] *Id.*

200 percent to 500 percent of his purchase price.[20] For this conduct, the indictment accuses Chastain of "insider trading." However, because NFTs are not generally considered securities, Chastain is not charged with securities fraud; he is instead charged with one count of wire fraud and one count of money laundering.[21]

By framing insider trading of NFTs as run-of-the-mill wire fraud, prosecutors have side-stepped the lack of guidance from securities regulators and avoided the thorny and fact-based inquiry of whether NFTs are, in fact, securities. The indictment also serves as a clear warning sign to firms trading in digital assets — whether NFTs are considered securities or not —the DOJ and federal investigators will "aggressively pursue" those who "exploit[] vulnerabilities [of any new investment tool] for their own gain."[22]

Looking Forward

Despite the Commission taking increasing interest in digital assets — including the July 21, 2022 announcement of insider trading charges against a former Coinbase manager and others based, in part, on the alleged insider trading of nine digital assets that the SEC claims are securities[23] — there remains a lack of rulemaking initiatives or concrete guidance defining what types of digital assets are or are not securities. But, as the Chastain indictment demonstrates, this limiting principle does not necessarily control whether charges are brought by law enforcement agencies.[24] In fact, in its "first ever cryptocurrency insider trading" case the DOJ also filed charges against the former Coinbase manager on the basis of wire fraud, not securities fraud.[25] Bringing cases under Section 1343 allows the DOJ to directly pursue insider trading charges against defendants engaged in wrongdoing in the trading in digital assets and avoid the analysis of whether digital assets fall under the securities laws.

With the expansion of insider trading liability to NFTs, firms that trade in digital assets should take caution when drafting and implementing trading policies and written supervisory procedures. For the first time, it may be prudent to consider expanding compliance functions such as pre-clearance trading requirements and restricted lists to include non-securities, in order to highlight the risks associated with trading digital assets under these circumstances.

[20] *Id.* at 6.

[21] *Id.* at 1, 7.

[22] *Former Employee of NFT Marketplace Charged in First Ever Digital Asset Insider Trading Scheme*, DOJ Press Release 22-180, June 1, 2022, available here.

[23] *SEC Charges Former Coinbase Manager, Two Others in Crypto Asset Insider Trading Action*, SEC Press Release No. 22-127, July 21, 2022, available here.

[24] *See infra* at n. 95-101.

[25] *Three Charged in First Ever Cryptocurrency Insider Trading Tipping Scheme*, DOJ Press Release No. 22-232, July 21, 2022, available here.

Fifth Circuit Decision Finds SEC's Use of Administrative Enforcement Proceedings Unconstitutional

On May 18, 2022, a divided panel of judges on the U.S. Court of Appeals for the Fifth Circuit invalidated, on constitutional grounds, the SEC's use of administrative proceedings in enforcement actions.[26] The case, *Jarkesy v. SEC*, raises serious complications for how the SEC exercises its enforcement authority, and, in turn, may help level the playing field for private parties defending themselves against an SEC investigation.

The Fifth Circuit reached three holdings in *Jarkesy*, each of which independently curtails the SEC's power to seek civil penalties through an administrative proceeding before a Commission-appointed administrative law judge ("ALJ"), rather than through the filing of an action in federal court. First, the court held that the SEC's use of administrative proceedings, which are decided by an ALJ, infringes upon the constitutional right to a jury trial. Second, the court held that Congress improperly delegated authority to the SEC to choose the forum in which to bring an enforcement action, in violation of separation-of-powers principles. Third, the court held that statutory protections against removal of SEC ALJs violates Article II of the Constitution.

The SEC often brings enforcement actions in front of ALJs. As a result of this decision, the SEC must reevaluate its approach for how it decides to pursue enforcement actions, including whether to bring more cases in front of federal courts. In the meantime, the SEC is seeking to overturn the Fifth Circuit's ruling, having petitioned the full Fifth Circuit to rehear the case *en banc*. There is a good chance that the important questions decided in *Jarkesy* will be before the U.S. Supreme Court sooner rather than later.

Background

Houston-based George Jarkesy and the investment adviser he founded, Patriot28 LLC (the "Petitioners"), established two hedge funds.[27] In 2011, the SEC launched an investigation into the Petitioners and later chose to bring an enforcement action before an ALJ within the agency against them and other former co-parties.[28] In that action, the SEC alleged that the Petitioners committed fraud by: (1) misrepresenting who served as the hedge funds' prime broker and auditor; (2) misrepresenting the funds' investment parameters and safeguards; and (3) overvaluing the funds' assets to increase the fees that they could charge investors, in violation of the Securities Act of 1933, the Securities Exchange Act of 1934 and the Investment Advisers Act of 1940.[29]

The Petitioners unsuccessfully tried to sue in the U.S. District Court for the District of Columbia to halt the agency proceedings on the basis that it infringed on their constitutional rights, but the case was dismissed in 2015 for lack of jurisdiction.[30] The proceedings against the Petitioners continued and an ALJ found they had committed securities fraud. The Commission ultimately ordered the Petitioners to cease and desist from further violations, pay a civil penalty of $300,000 and disgorge ill-gotten gains of nearly $685,000; it also barred Jarkesy from various securities

[26] *Jarkesy v. Securities and Exchange Commission*, 34 F.4th 446 (2022).

[27] *Id*. at 450.

[28] *Id*.

[29] *Id*.

[30] *Id*.

industry activities.[31] In its decision, the Commission rejected the various constitutional arguments the Petitioners raised.[32] An appeal to the Fifth Circuit followed.[33]

The Fifth Circuit determined that there were three independent constitutional defects in the proceedings: (1) Petitioners were deprived of their constitutional right to a jury trial; (2) Congress unconstitutionally delegated legislative power to the SEC by failing to provide it with an intelligible principle by which to exercise the delegated power; and (3) statutory removal restrictions on SEC administrative law judges violated Article II of the Constitution.[34]

Jury-Trial Right and SEC Administrative Enforcement Proceedings

The Fifth Circuit determined that the SEC's use of an ALJ deprived the Petitioners of their Seventh Amendment right to a jury trial because SEC administrative proceedings are "akin to traditional actions at law to which the jury-trial right attaches."[35] Specifically, the court interpreted the Seventh Amendment, which protects the right to trial by jury "[i]n Suits at common law," to apply to suits brought by government agencies seeking statutory civil penalties that resemble traditional common law claims like fraud.[36]

The majority of the Fifth Circuit panel acknowledged that Congress has the power to assign actions to an administrative fact-finder, rather than a jury, if a case concerns government enforcement of "public rights."[37] The Fifth Circuit noted, however, that if the SEC were seeking the same sort of civil penalties in a federal court action alleging securities fraud the Petitioners would have had a Seventh Amendment right to a jury trial.[38]

The court held that the "public rights" doctrine does not permit the SEC to circumvent the Petitioners' right to a jury trial by choosing to bring an administrative proceeding in lieu of a court action, reasoning that the SEC's claims were in the nature of traditional "common law" claims (*i.e.*, fraud) and were not "uniquely suited" for agency adjudication.[39]

The dissenting judge disagreed with this conclusion, citing Supreme Court precedent that describes the "public rights" doctrine in broader terms to encompass cases in which the government sues in its sovereign capacity to enforce public rights created by statute.[40] In addition, the dissent noted that sister circuits routinely hold that enforcement actions for violations of a federal statute or regulation fall within the public rights doctrine.[41]

[31] *Id.*

[32] *Id.*

[33] Petitioners were able to appeal their case to the Fifth Circuit because they resided in and had a principal place of business in Texas.

[34] *Jarkesy* at 451.

[35] *Id.*

[36] *Id* at 452 (quoting U.S. Const. amend. VII).

[37] *Jarkesy* at 453 (internal citation omitted).

[38] *Id.* at 455.

[39] *Id.* at 454-456.

[40] *Id.* at 467 (Davis, J. dissenting).

[41] *Id.* at 468 (Davis, J. dissenting).

Under the majority's holding, the SEC would not be able to bring certain cases in front of ALJs without a waiver of Seventh Amendment rights. At the very least, that would include garden-variety claims for securities fraud.

Delegation of Authority to the SEC

The Fifth Circuit also held that Congress unconstitutionally delegated legislative power to the SEC when it gave the SEC the unchecked authority to choose whether to bring enforcement actions in court or within the agency.[42]

The legal standard for a proper delegation of authority requires only that Congress provide the agency with an "intelligible principle" to guide its use of that delegated power.[43] The majority of the Fifth Circuit panel found that Congress "offered *no guidance* whatsoever" to the SEC.[44] In the roughly 80 years since that standard has been used to evaluate these cases, the Supreme Court has never found there to be an improper delegation of authority.

The dissent criticized the majority's determination as a departure from the extensive precedent regarding proper delegation of authority. In doing so, the dissent noted precedent where the Supreme Court has "analogized agency enforcement decisions to prosecutorial discretion exercised in criminal cases," and argued that the SEC's forum-selection authority is part of its prosecutorial authority.[45]

While the Fifth Circuit's Seventh Amendment holding discussed above might still allow the SEC to pursue certain kinds of securities law violations that do not resemble a traditional fraud claim before an ALJ, the delegation-of-authority holding is more far-reaching. It would appear to bar the SEC from bringing any administrative proceeding for any violation of the securities laws where it could otherwise have chosen to file suit in federal court — unless Congress changes the law to provide an "intelligible principle" to guide the SEC's exercise of its power.

Removal Restrictions on SEC Administrative Law Judges

The Fifth Circuit's final holding is that the statutory removal restrictions for SEC ALJs is unconstitutional.[46] By statute, SEC ALJs are protected from removal by two layers of for-cause protection. Specifically, SEC ALJs can only be removed by the SEC Commissioners if good cause is found by the Merits Systems Protection Board.[47] In turn, SEC Commissioners and Merits Systems Protection Board members can only be removed by the President for cause.[48]

The majority of the Fifth Circuit panel thought this double layer of insulation interfered with the President's Article II powers to faithfully execute the laws.[49] In recent years, the Supreme Court has broadly construed Article II's Appointments Clause to protect the President's control over the appointment and removal of "inferior officers" of the executive branch. The majority found that this precedent rendered the statutory restrictions on removal of SEC ALJs invalid because ALJs are "inferior officers" who "perform substantial executive functions."[50]

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[42] *Id.* at 459.

[43] *Id*

[44] *Id.* at 462.

[45] *Id* at 474 (Davis, J. dissenting).

[46] *Id.* at 463.

[47] *Id.* at 464.

[48] *Id.*

[49] *Id.* at 463.

[50] *Id.* at 463-64.

The dissent disagreed, instead adopting the SEC's argument that ALJs perform an adjudicative function and therefore are not "inferior officers" for purposes of Article II of the Constitution.[51]

The impact of the majority opinion on this issue, standing alone, is unclear. The Supreme Court has not definitively settled what the proper remedy is for a violation of the Appointments Clause. The Fifth Circuit declined to reach this issue, since the order against the Petitioners had to be vacated in any event as a result of the court's first two rulings.[52]

Looking Ahead

On July 6, 2022 the SEC petitioned the full Fifth Circuit to rehear the case *en banc*, echoing the arguments made in the dissenting opinion. If the SEC does not succeed with its request for rehearing, it can be expected to petition the Supreme Court for a writ of certiorari.

In the meantime, the Fifth Circuit's decision is binding precedent only in the federal courts located in Texas, Louisiana and Mississippi. But the decision could have an immediate impact outside the Fifth Circuit as well. While the SEC may have been dismissive of the constitutional challenges to its administrative enforcement powers in the past, the agency must now confront the reality that one federal circuit court has endorsed the arguments of its adversaries, heightening the risk that victories it may procure through the administrative process will later be undone. The SEC could decide to play it safe and avoid that risk by bringing cases it previously may have pursued administratively in federal court instead. *Jarkesy* may also have broader implications for other regulators. For example, the CFTC's enforcement framework is quite similar to that of the SEC. Challenges might also be made to other federal regulatory enforcement schemes that rely on ALJs or on an administrative process to impose fraud-based civil penalties.

Whether *Jarkesy* will stand the test of time remains to be seen. The Fifth Circuit is considered one of the most conservative circuit courts in the country, and the two panel members who comprised the *Jarkesy* majority, appointed by Presidents George W. Bush and Donald J. Trump, are former members of the Federalist Society. The dissenting judge, though also appointed by a Republican President, Ronald Reagan, strongly disagreed with the majority's analysis on each point. However, the majority's opinion does echo many of the criticisms of the modern administrative state and government-friendly precepts of administrative law that have been expressed by several current Supreme Court Justices.

Notably, the Supreme Court has decided to hear next term a related case out of the Fifth Circuit that, if upheld, would make it easier for defendants to challenge ALJ proceedings. That case, *SEC v. Cochran*, U.S., No. 21-1239, deals with the procedural issue of whether a defendant can challenge the constitutionality of an SEC ALJ without having to first go through the complete internal agency review process (the issue that Jarkesy lost on in the D.C. Circuit). If the Supreme Court upholds that ruling, then defendants in SEC proceedings would be able to raise constitutional challenges directly in federal courts. This could precipitate decisions by other federal courts of appeals agreeing — or disagreeing — with the majority opinion in *Jarkesy.* The Supreme Court's decision in *Cochran* could also signal where it stands on the merits of the constitutional issue. One way or another, the Supreme Court will have its say on SEC ALJs.

[51] *Id.* at 475 (Davis, J. dissenting).

[52] *Id.* at 465-66.

SEC's Proposed SPAC Rules Likely to Spur Increased Enforcement Activity

At the close of last quarter, the SEC proposed new rules and amendments (the "Proposed SPAC Rules") that would enhance disclosure requirements and investor protections in initial public offerings ("IPOs") by special purpose acquisition companies ("SPACs") and in business combination transactions involving shell companies, such as SPACs ("de-SPACs").[53]

Chair Gensler has made it clear that he views the SEC's Division of Enforcement as the "cop on the beat" when it comes to "ensur[ing] that investors are being protected in the SPAC space."[54] And the Proposed SPAC rules also follow a year of novel enforcement activity in the SPAC space echoing the SEC's concern with the quality and truthfulness of disclosures to investors:

- On July 13, 2021, in the matter of Momentus, Inc., the SEC announced settled charges against the SPAC, Stable Road Acquisition Company; its sponsor, SRC-NI; its CEO, Brian Kabot; its proposed merger target, Momentus Inc.; and Momentus' founder and former CEO, Mikhail Kokorich, for misleading claims about Momentus' technology and national security risks associated with Kokorich.[55] According to the SEC's order, Momentus and Kokorich made multiple misrepresentations to investors, including telling investors that Momentus had succeeded in testing its propulsion technology in space and misrepresenting its ability to secure required government licenses due to national security concerns about Kokorich. Stable Road allegedly repeated these misrepresentations in public filings associated with the proposed transaction and failed to satisfy disclosure obligations to its investors.

- On July 29, 2021, the SEC charged the founder, former CEO and former Executive Chairman of Nikola Corporation, Trevor Milton, with violating the antifraud provisions of the Securities Act and the Exchange Act.[56] According to the SEC's complaint, Milton helped Nikola raise more than $1 billion and go public through a SPAC. Milton allegedly acted as Nikola's primary spokesperson and repeatedly misled investors about, among other things, Nikola's technological advancements, products, in-house production capabilities and commercial achievements. According to the complaint, Milton made tens of millions of dollars as a result of the alleged misconduct. On Dec. 21, 2021, the SEC announced a settlement with Milton and Nikola in which Nikola agreed to pay $125 million to settle charges that "it defrauded investors by misleading them about its products, technical advancements, and commercial prospects." [57]

- On Oct. 27, 2021, the SEC announced settled charges against Akazoo S.A. ("SONG"), a music streaming platform formed through a de-SPAC transaction between Modern Media Acquisition Corp. and Akazoo Ltd., for allegedly defrauding investors through false and misleading statements regarding its revenue,

[53] SEC, Proposed Rules, Special Purpose Acquisition Companies, Shell Companies, and Projections, Release No. 33-11048 (March 30, 2022), available here.

[54] Gary Gensler, *Remarks Before Healthy Markets Association Conference,* Dec. 9, 2021, available here.

[55] *Momentus, Inc., et al.,* Securities Act Release No. 10955, July 13, 2021, available here.

[56] Complaint, *SEC v. Trevor R. Milton*, No. 1:21-cv-6445 (S.D.N.Y. July 29, 2021), available here.

[57] *Nikola Corporation to Pay $125 Million to Resolve Fraud Charges*, SEC Press Release No. 2021-267, Dec. 21, 2021, available here.

operations and subscriber count.[58] According to the complaint, Akazoo Ltd. misrepresented its growth, users and revenue, before entering into a de-SPAC transaction, while in reality, it had no or few users and negligible revenue. After the resulting company was publicly listed on Nasdaq, SONG allegedly continued to misrepresent its revenue, user base and growth, while its primary source of funding remained investors. As part of the settlement, the SEC will allow SONG to satisfy its disgorgement through the payment of settlement proceeds in related private litigation with investors.[59]

The SEC also is continuing to investigate a number of companies formed through de-SPAC transactions, with certain of those investigations having been disclosed by the SPACs or the companies themselves in public filings.[60] In addition, the plaintiff's bar has been aggressively filing securities class actions alleging that the public disclosures relating to SPACs and resulting de-SPAC transactions are false and misleading. These matters may also be impacted by the ultimate adoption of the Proposed SPAC Rules in some form.

Overall, the Proposed SPAC Rules aim to better align the regulatory treatment of SPAC transactions with that of traditional IPOs in light of the SEC's view that the method in which a company chooses to go public should not affect investor protections.[61] Such increased scrutiny may expose many of the entities involved in the SPAC process to increased liability and regulatory scrutiny due to increased disclosure requirements with respect to: (1) sponsors, (2) conflicts of interest, (3) dilution and (4) the fairness of these business combination transactions.

The Proposed SPAC Rules also include a new safe harbor provision that exempts SPACs that satisfy certain conditions from being considered investment companies under the Investment Company Act of 1940 ("1940 Act"), including a new fixed timeline for de-SPAC transactions. The proposed adoption of such a prescriptive safe-harbor provision may also raise challenges with respect to existing SPACs that may need to extend their life cycle in order to complete a business combination, or otherwise fall outside of the narrow guidelines included in the proposed 1940 Act safe-harbor provision.

A detailed analysis by SRZ of the Proposed SPAC Rules is available here.

What This Might Mean

The proposed rules in many respects represent a significant deviation from the SEC's historical treatment of, and stance towards, SPACs. Among other things, many of the new disclosure-related rules, which include adjustments to address the use of projections and forward-looking statements in connection with de-SPAC transactions, mirror the enhanced disclosure requirements the SEC has typically used in connection with going-private transactions, where the SEC believes similar conflicts exist. In addition, if adopted, several of the rule changes will likely have a material impact on both de- SPAC transactions and the SPAC market generally.

[58] *Post-SPAC Music Streaming Company Reaches $38.8 Million Settlement in Ongoing Fraud Action*, SEC Press Release No. 2021-216, Oct. 27, 2021, available here; *see also* Complaint, *SEC v. Akazoo S.A.*, No. 1:20-cv-08101 (S.D.N.Y. filed Sept. 30, 2020), available here.

[59] Agreed Final Judgment, *SEC v. Akazoo S.A.*, Docket No. 1:20-cv-08101 (S.D.N.Y. filed Oct. 27, 2021), available here; *See also In re Akazoo S.A. Securities Litigation*, Docket No. 1:20-cv-01900 (E.D.N.Y. Sept. 8, 2020); *Pareja, et al. v. Apostolos N. Zervos, et al.*, Docket No. 2020CV3374 l 8 (Superior Court for the State of Georgia, Fulton County).

[60] These companies include: (i) Clover Health Investments, Corp., SEC Form 8-K (Feb. 4, 2021), available here; (ii) Lordstown Motors Corp., Post-Effective Amendment No. 2 to SEC Form S-1, (July 15, 2021), available here; (iii) Canoo Inc., SEC Form 10-Q, (May 10, 2021), available here; (iv) MoneyLion, (via Fusion Acquisition Corp.), Amendment No. 1 to SEC Form S-4, (June 8, 2021), available here; (v) Lucid Motors, SEC Form 8-K, (Dec. 3, 2021), available here; and (vi) Digital World Acquisition Corporation, SEC Form 8-K, (Dec. 4, 2021), available here, SEC Form 8-K, (June 16, 2022) available here , available here (also disclosing receipt of a grand jury subpoena from the U.S. Attorney's Office for the Southern District of New York).

[61] *Supra* note 50 at 66.

That said, the Proposed SPAC Rules came as no surprise and were widely expected after Chair Gensler's remarks before the Healthy Markets Association Conference in December 2021. [62] At that time, Chair Gensler disclosed that he asked the staff for "proposals . . . how to better align the legal treatment of SPACs and their participants with the investor protections provided in other IPOs, with respect to disclosure, marketing practices, and gatekeeper obligations."[63] To mitigate the risk of regulatory scrutiny, those involved in a SPAC merger should: (1) take care to disclose all potential conflicts; (2) ensure accurate, complete and clearly presented disclosures; and (3) take the time to complete proper due diligence on acquisition targets. As the Proposed SPAC Rules proceed through the formal notice and comment process, SPAC market participants should keep a close eye on the SEC's ongoing enforcement activities, which often serve as a leading indicator of the SEC's views.

[62] Gary Gensler, *Remarks Before Healthy Markets Association Conference,* Dec. 9, 2021, available here.

[63] *Id.*

Recent Enforcement Actions[64]

Investment Adviser Enforcement Actions

A. Misappropriation of Investor Funds: *SEC v. Shawn E. Good*

The SEC remains committed and focused on protecting vulnerable investors from fraudulent conduct of their investment advisers. On April 18, 2022, the SEC announced the filing of an emergency injunctive action and charged Wilmington, North Carolina-based broker and investment adviser Shawn Good ("Good") with defrauding clients and misappropriating millions of dollars of investor funds.[65]

According to the Complaint, beginning in or about December 2012 and continuing through at least February 2022, Good raised at least $4.8 million from five of his clients at Morgan Stanley Smith Barney, LLC ("Morgan Stanley"). Good allegedly targeted "novice investors" and enticed them to make supposedly low-risk investments in tax-free bonds and land development projects. Instead of investing the money as represented, Good allegedly used the funds to repay prior victims and to pay for personal expenses, including luxury cars, international travel and approximately $800,000 in credit card bills. The SEC alleged that based on bank records and other evidence, Good's actions caused $2 million in investor losses.

The Complaint charged Good with violating the antifraud provisions of Section 17(a) of the Securities Act of 1933 (the "Securities Act"), Section 10(b) of the Securities Exchange Act of 1934 (the "Exchange Act") and Rule 10b-5 thereunder, and Sections 206(1) and 206(2) of the Investment Advisers Act of 1940 (the "Advisers Act"). The SEC sought a temporary restraining order, preliminary and permanent injunctive relief, an asset freeze, an accounting, disgorgement of ill-gotten gains plus prejudgment interest thereon, and civil penalties.

B. Offering Fraud by Promoters of Fictitious Automated Cryptocurrency Fund: *SEC v. Block Bits Capital, LLC, et al.* and *SEC v. David B. Mata*

False and misleading statements about the cryptocurrency trading strategy concealed material facts about the fund's performance and investor losses. On April 27, 2022, the SEC announced the filing of a partially contested injunctive action in the U.S. District Court for the Northern District of California against Block Bits Capital, LLC, Block Bits Capital GP I, LLC (collectively "Block Bits") and their co-founders Japheth Dillman and David Mata, charging them with conducting, among other things, a fraudulent and unregistered offer and sale of securities.[66]

In its Complaint, the SEC alleged that from at least July through December 2017, San Francisco-based Block Bits, and defendants Dillman and Mata raised at least $960,000 from 22 retail investors. Defendants are charged with making misrepresentations to investors about an in-house proprietary automated digital asset trading "bot" that would purportedly trade a hundred different digital assets over three different trading platforms to maximize investor returns. However, Block Bits never developed the automated trading bot, and, instead, Mata would manually trade

[64] The enforcement proceedings described below are based on allegations by the SEC, CFTC, DOJ and other agencies that either are being contested in active litigation or are part of a settled action in which the respondents have agreed to "neither admit nor deny" the allegations.

[65] Complaint, *SEC v. Shawn E. Good*, No. 7:22-cv-00060-D (E.D.N.C. April 18, 2022), available here.

[66] Complaint, *SEC v. Block Bits Capital, LLC, et al.*, No. 3:22-cv-2563 (N.D. Cal. April 27, 2022), available here; Complaint, *SEC v. David B. Mata*, No. 3:22-cv-2565 (N.D. Cal. April 27, 2022), available here.

digital assets. Dillman, the alleged chief architect of the fraud, also falsely claimed that the fund's assets were invested in purported risk-free "cold storage" deals that would generate substantial returns. In reality, at no time were any of Block Bits' assets stored in such risk-free "cold storage" deals. Instead, Dillman and Mata used the funds for high-risk loans and to invest in the initial coin offering of another digital asset, AML Bitcoin, which the SEC previously alleged was a fraudulent unregistered securities offering in *SEC v. NAC Foundation, LLC, et al.*, No. 3:20-cv-04188 (N.D. Cal. June 25, 2020).

The SEC's Complaint charges Block Bits, Dillman and Mata with violating Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and Sections 206(1), (2) and (4) of the Advisers Act and Rule 206(4)-8 thereunder. The SEC seeks permanent injunctions, disgorgement with prejudgment interest and civil penalties. For his part, Mata agreed to entry of a judgment imposing permanent and conduct-based injunctions, disgorgement of $75,000 plus prejudgment interest of $11,624, and a civil penalty to be determined by the court. Mata further agreed to an entry of an order barring him from association with any broker, dealer, investment adviser, municipal securities dealer, municipal adviser, transfer agent or nationally recognized statistical rating organization.[67] Block Bits and Dillman are contesting the SEC's allegations.

The U.S. Attorney's Office for the Northern District of California also announced parallel criminal actions for wire fraud against Dillman and Mata.[68]

C. Misidentifying Sale Orders: *In re Maplelane Capital LLC*

Misidentifying short sale orders as long orders triggers Advisers Act and Regulation SHO violations. On May 2, 2022, the SEC announced the filing of settled administrative proceedings against registered investment adviser Maplelane Capital LLC ("Maplelane") in connection with incorrectly identifying "short sale" orders as "long sale" orders.[69]

In its Order Instituting Proceedings, the SEC finds that Maplelane caused its executing brokers to violate the marking and locate requirements of Regulation SHO ("Reg SHO"), Rules 200(g) and 203(b), by misidentifying 358 short sales as long sales from at least November 2016 to June 2021. The Order finds that Maplelane identified those 358 orders as long, despite having a net flat or net short position in their securities. The Order also finds that Maplelane's conduct violated the books and records provisions of the Advisers Act, and that Maplelane failed to implement required policies and procedures for maintaining accurate books and records.

The Order finds that Maplelane violated or caused violations of Reg SHO Rules 200(g) and 203(b)(1), as well as Advisers Act Sections 204 and 206(4) and Rules 204-2(a)(3), 204-2(a)(7)(iii), and 206(4)-7 thereunder. Maplelane was ordered to cease and desist, pay disgorgement of $554,721, prejudgment interest of $19,320 and a civil monetary penalty of $250,000. The Order notes that the SEC considered Maplelane's remedial efforts in making its determination to accept the settlement offer.

[67] *SEC Charges Promoters of "Automated Cryptocurrency Fund" with Fraud and Registration Violations*, SEC Press Release No. 25376, April 28, 2022, available here.

[68] *San Francisco Man Charged In Alleged Cryptocurrency Investor Fraud Scheme*, DOJ Press Release, April 27, 2022, available here.

[69] *Maplelane Capital LLC*, Advisers Act Release No. 6011, May 2, 2022, available here.

D. Concealing Investment Risks and Falsifying Data: *SEC v. Allianz Global Investors U.S. LLC*; *SEC v. Gregoire P. Tournant.*

Parallel civil and criminal charges filed against investment adviser and its employees for what the SEC characterized as a fraudulent scheme to disguise fund losses. On May 17, 2022, the SEC announced the filing of an injunctive action in the U.S. District Court for the Southern District of New York against Gregoire P. Tournant, Trevor L. Taylor and Stephen G. Bond-Nelson, former senior portfolio managers previously associated with registered investment adviser Allianz Global Investors U.S. LLC ("AGI US"), for an alleged fraudulent scheme to disguise losses associated with AGI US funds.[70] At the same time, the SEC also announced the filing of a settled administrative proceedings against AGI US arising from the same alleged conduct.[71] Defendants Taylor and Bond-Nelson have agreed to settle the SEC charges against them, including having consented to associational bars and bars from participating in penny stock offerings.[72] That day, the U.S. Attorney's Office for the Southern District of New York also announced criminal charges against AGI US and the three senior portfolio managers for their roles in the alleged fraud scheme, to which AGI US, Taylor and Bond-Nelson have pleaded guilty.[73]

In its Complaint, the SEC alleged that Tournant, Taylor and Bond-Nelson (collectively, the "Individual Defendants") manipulated and falsified information provided to investors to disguise the downside risks of the so-called Structured Alpha Funds ("Funds") and to cover up associated losses. According to the Complaint, the misrepresentations were made to approximately 114 institutional investors in 17 unregistered private funds. The Funds were allegedly marketed as a portfolio of debt and equity securities as collateral for the purchase and sale of options on the S&P 500 Index. The Individual Defendants are accused of manipulating reports and other information created for investors, which mislead investors as to fund performance and mechanics of the strategy. For its part, the Complaint alleged, AGI US failed to monitor investor communications related to the Funds.[74]

With respect to non-settling defendant Tournant, the SEC's Complaint further alleges that he failed to implement a risk mitigation program that was agreed to with an investor and manipulated risk mitigation program reports in order to increase his compensation and to hide the failure to implement the risk mitigation program. The SEC also alleges that Tournant misrepresented the capacity limit for certain funds and the levels at which hedging positions were put in place for the Funds.

The Complaint charges the Individual Defendants with violations of Securities Act Section 17(a), Exchange Act Section 10(b) and Rule 10b-5 thereunder, and Advisers Act Sections 206(1), 206(2) and 206(4), and Rule 206(4)-8 thereunder. The Complaint seeks an injunction from further violations, disgorgement of ill-gotten gains plus prejudgment interest and civil money penalties. The Complaint also seeks to have Tournant permanently prohibited from acting as an officer or director.

Taylor and Bond-Nelson have agreed to the entry of partial judgments in the civil matter that include injunctive relief, with monetary relief to be determined by the court, and have consented to industry and penny-stock bars as

[70] *SEC Charges Allianz Global Investors and Three Former Senior Portfolio Managers with Multibillion Dollar Securities Fraud*, SEC Press Release No. 2022-84, May 17, 2022, available here.

[71] *Allianz Global Investors U.S. LLC*, Exchange Act Release No. 94927, May 17, 2022, available here.

[72] *Trevor L. Taylor*, Exchange Act Release No. 94925, May 17, 2022, available here; *Stephen G. Bond-Nelson*, Exchange Act Release No. 94926, May 17, 2022, available here.

[73] *Three Portfolio Managers and Allianz Global Investors U.S. Charged in Connection with Multibillion-Dollar Fraud Scheme*, DOJ Press Release No. 22-519, May 17, 2022, available here.

[74] Complaint, *SEC v. Gregoire P. Tournant, et al.*, No. 1:22-cv-4016 (S.D.N.Y. May 17, 2022), available here.

noted above.[75] Similarly, both have pled guilty to various fraud charges in their corresponding criminal cases, *United States v. Trevor Taylor*, Case No. 22-cr-149 (S.D.N.Y.), and *United States v. Stephen Bond-Nelson*, Case No. 22-cr-137 (S.D.N.Y.).

With respect to AGI US, it reached a global resolution with the SEC and DOJ. The SEC's Order finds that AGI US violated Exchange Act Section 10(b) and Rule 10b-5 thereunder, and Advisers Act Sections 206(1), 206(2), 206(4), and Rules 206(4)-7 and 206(4)-8 thereunder, violations that AGI US has admitted. AGI US was ordered to cease and desist, was censured and was ordered to pay disgorgement of $315.2 million plus prejudgment interest of $34 million (which can be satisfied by forfeiture and restitution ordered in the settlement of parallel criminal charges in *United States v. Allianz Global Investors U.S. LLC* (S.D.N.Y.)) and pay a civil money penalty of $675 million. As a result of its guilty plea to the criminal charges, AGI US is automatically and immediately disqualified from providing U.S.-registered investment funds with adviser services for ten years, and must pay over $3 billion in restitution, pay a criminal fine of approximately $2.3 billion and forfeit approximately $463 million.

E. ESG Misrepresentations: *In re BNY Mellon Investment Adviser, Inc*.

As Environmental, Social and Governance ("ESG") factors become more important to investors, the SEC is paying attention to representations made regarding ESG. On May 23, 2022, the SEC announced the filing of settled administrative proceedings against registered investment adviser BNY Mellon Investment Adviser, Inc. ("BNY Mellon") for making material misstatements and omissions regarding ESG considerations in making investment decisions for certain mutual funds that it managed.[76]

In its Order Instituting Proceedings, the SEC finds that from July 2018 to September 2021, BNY Mellon, via prospectuses to investors, representations to the boards of mutual funds and written responses to requests for proposals from other investment firms, represented or implied that investments in certain mutual funds had undergone an ESG quality review. The SEC finds, however, that numerous investments of those funds did not have an ESG quality review. The Order also finds that BNY Mellon failed to adopt and implement policies and procedures to prevent inaccurate or materially incomplete statements regarding the use of ESG quality reviews when selecting investments.

BNY Mellon settled the SEC's charges that it violated Advisers Act Sections 206(2) and 206(4) and Rules 206(4)-7 and 206(4)-8 thereunder, as well as Investment Company Act Section 34(b). The Order imposed sanctions of a censure, a cease and desist and a $1.5 million civil monetary penalty. The Order acknowledges BNY Mellon's remedial acts and cooperation with the SEC's investigation in determining to accept the settlement.

F. Misrepresentation About Mutual Fund Performance: *In re Garrison Point Capital, LLC* and *In re AlphaCentric Advisors LLC*

Failure to properly calculate a fund's net asset value and misleading disclosures about a fund's performance result in Advisers Act violations for both the registered investment adviser and the fund. On June 3, 2022, the SEC announced the filing of settled administrative proceedings against Garrison Point Capital, LLC ("Garrison Point") the subadviser to the AlphaCentric Income Opportunities Fund ("AlphaCentric") for overstating the fund's daily net asset value and making misleading disclosures regarding the same. On the same day, the SEC announced a cease-and-desist

[75] *Supra* note 69.

[76] *BNY Mellon Investment Adviser, Inc.*, Advisers Act Release No. 6032, May 23, 2022, available here.

proceeding against AlphaCentric for failure to implement policies and procedures to prevent violation of the Advisers Act for the same conduct.[77]

In its Order Instituting Proceedings against Garrison Point, the SEC finds that Garrison Point caused AlphaCentric to overstate its daily net asset value ("NAV") and performance by misvaluing 42 small "odd-lot" bonds. Right after Garrison Point purchased the bonds for AlphaCentric, it valued the bonds at higher prices that were intended for round-lot positions, not odd lots. This led to a seven percent overvaluation in 2015, which AlphaCentric reported. The Order also finds that Garrison Point provided materially inaccurate information regarding the sources of AlphaCentric's performance to investors in quarterly marketing materials through at least March 2016, in an investor webinar in February 2016 and in the AlphaCentric's first annual shareholder report filed with the Commission on June 10, 2016. The Order also finds that Garrison Point failed to implement its own compliance policies through 2017.

In its Order concerning AlphaCentric, the SEC alleges that regarding the odd-lot positions, AlphaCentric failed to implement its valuation policies and procedures, which required it to reflect the fair value of AlphaCentric holdings in accordance with its valuation procedures. It also alleges that AlphaCentric failed to review daily the pricing of its holdings for reasonableness. According to the SEC, from January 2017 to February 2019, AlphaCentric also failed to implement its compliance policies and procedures concerning its role in valuing its securities holdings, which required it to follow its valuation procedures. The Order explained that during that period, when Garrison Point thought that a Pricing Vendor Mark for bonds held by AlphaCentric was too low, Garrison Point placed bids with certain broker-dealers. It thereby allegedly expressed to the broker-dealers its interest in purchasing those bonds at prices higher than the Pricing Vendor Marks, reflecting Garrison Point's view of the bonds' value. Afterwards, Garrison Point is alleged to have provided the Pricing Vendor with those bids, which it disclosed to the Pricing Vendor as its own, in order to persuade the vendor to increase its marks on the bonds. In response, the Order states, the Pricing Vendor increased its marks for those bonds and AlphaCentric priced the securities based on the increased marks. The Order notes that AlphaCentric delegated pricing responsibilities to Garrison Point. Notwithstanding that delegation, the SEC alleges that AlphaCentric did not adopt policies and procedures to provide oversight of Garrison Point's fulfillment of these duties, including with respect to Garrison Point's interactions with the Pricing Vendor.

Specifically, the SEC finds that Garrison Point violated Section 206(4) of the Advisers Act and violated Section 34(b) of the Investment Company Act and Rule 22c-1 thereunder. The SEC ordered Garrison Point to cease and desist its violations and pay a civil penalty in the amount of $3.5 million to the SEC. For its part, the SEC found AlphaCentric to have committed willful violations of Section 206(4) of the Advisers Act and Rule 206(4)-7 thereunder.

G. Penny Stock Fraud: *SEC v. LG Capital Funding, LLC, et al.*

The SEC alleges failure to register as a dealer arising from trading in notes convertible into microcap "penny" stocks. On June 7, 2022, the SEC announced the filing of a contested injunctive action in the U.S. District Court for the Northern District of New York against LG Capital Funding, LLC ("LG Capital") and its managing member Joseph Lerman for their failure to register as securities dealers with the SEC.[78] The SEC also named Daniel Gellman, Boruch

[77] *Garrison Point Capital, LLC*, Advisers Act Release No. 6039, June 3, 2022, available here; *AlphaCentric Advisors, LLC*, Advisers Act Release No. 6040, June 3, 2022, available here.

[78] Complaint, *SEC v. LG Capital Funding, LLC, et al.*, No. 22-cv-3353 (N.D.N.Y. June 7, 2022), available here.

Greenberg and Eli Safdieh as relief defendants for the recovery of ill-gotten gains allegedly generated as a result of LG Capital and Lerman's unlawful conduct.

In its Complaint, the SEC alleges that LG Capital and Lerman bought and sold billions of newly-issued shares of microcap securities, or "penny stocks," which generated millions of dollars for LG Capital and Lerman without being registered as a dealers with the SEC. At Lerman's direction, LG Capital bought convertible notes from penny stock issuers, converted them to unrestricted, newly issued shares of penny stocks at a discount to par and resold them quickly in public markets, generating gross profits for LG Capital and its principals exceeding $20 million.

For the alleged violations of Section 15(a)(1) of the Exchange Act by Lerman and LG Capital, the SEC is seeking a permanent injunction, disgorgement of ill-gotten gains plus prejudgment interest, a civil penalty, a penny stock bar and other equitable relief.

H. Failure to Adequately Disclose Risks: *In re UBS Financial Services, Inc.*

As fiduciaries, investment advisers have an obligation to properly disclose the risks of recommended investments. On June 29, 2022, the SEC announced the filing of settled administrative proceedings against UBS Financial Services Inc. ("UBS") for promoting an options trading strategy in violation of the Advisers Act and for failure to implement policies and procedures reasonably designed to prevent such violations.[79]

In its Order Instituting Proceedings, the SEC finds that UBS marketed and sold its Yield Enhancement Strategy ("YES") options trading strategy to approximately 600 investors in 2016-2017. During that time, UBS failed to provide its financial advisers with adequate training in YES and failed to provide both its advisers and clients with all relevant data concerning the risk of investing in YES. As a result, UBS' financial advisers did not appreciate or understand the downside risk of YES, and failed to disclose that risk to investors. The SEC finds that the YES strategy generated modest profits for a few years, but that when market volatility increased, it began experiencing significant unanticipated losses.

The Order finds that UBS violated Section 206(2) and 206(4) of the Advisers Act, and as a result UBS was ordered to cease and desist from any further violations and was censured. UBS was ordered to pay disgorgement in the amount of $5.8 million and prejudgment interest in the amount of $1.4 million, which the SEC deemed was satisfied by payments previously made by UBS to investors in the YES strategy in excess of that amount. Further, UBS was ordered to pay a civil monetary penalty in the amount of $17.4 million.

[79] *UBS Financial Services, Inc.*, Advisers Act Release No. 6060, June 29, 2022, available here.

Broker-Dealer Enforcement Actions

A. Failure to Disclose Prior Securities Violations and Industry Bars: *SEC v. Joseph Salvatore DeVito (a/k/a Salvatore DeVito), et al.*

The SEC charges recidivist boiler room operators for the sale of unregistered securities. On April 14, 2022, the SEC announced the filing of a contested injunctive action in the U.S. District Court for the Southern District of Florida, against Boca Raton, Florida residents Joseph Salvatore DeVito (a/k/a Salvatore DeVito) and Dean Anthony Esposito (a/k/a Dean Anthony) for unlawfully acting as unregistered brokers and hiding their histories of securities law violations while soliciting investments in unregistered offerings of securities.[80]

In its Complaint, the SEC alleges that from at least October 2016 through February 2019, as part of a network of unregistered sales agents of Property Income Investors LLC and certain related companies (together, "PII"), DeVito and Esposito solicited and raised money from investors in a series of unregistered securities offerings by PII through a cold-calling campaign. The purported purpose of the offerings was to raise money for the purchase of multifamily properties located in South Florida, which would then be renovated, rented to tenants and eventually sold. The Complaint alleges that DeVito and Esposito were not registered as brokers or associated with registered broker-dealers. While DeVito and Esposito were engaged in marketing investments for PII, each was allegedly already the subject of prior SEC permanent injunctions for violating the antifraud and registration provisions of the federal securities laws, and barred from the securities industry. DeVito and Esposito allegedly deceived investors in the PII offerings by actively concealing from investors their significant histories of securities violations and that they were prevented from selling these securities due to their industry bars. The Complaint alleges that DeVito and Esposito used pseudonyms in their communications with PII's investors, thereby hiding their disciplinary history and industry bars.

The SEC's Complaint charges DeVito and Esposito with violating the antifraud and securities offering and broker-deal registration provisions of the federal securities laws, and for violating prior SEC orders against them. Specifically, it alleges that DeVito and Esposito violated Sections 5(a) and 5(c), and 17(a)(1) and 17(a)(3) of the Securities Act and Sections 10(b), 15(a)(1), and 15(b)(6)(B) of the Exchange Act and Rules 10b-5(a) and (c) thereunder. The Complaint seeks permanent injunctions, additional conduct-based injunctions, penny stock and officer and director bars, disgorgement plus prejudgment interest, civil monetary penalties and a court order requiring DeVito and Esposito to comply with prior SEC Orders.

B. Late Suspicious Activity Reports: *In re Wells Fargo Clearing Services, LLC*

The SEC continues to scrutinize the anti-money laundering ("AML") obligations of registered entities and whether their systems are properly supporting these obligations. On May 20, 2022, the SEC announced the filing of a settled administrative proceeding against dual-registered broker-dealer and investment adviser Wells Fargo Clearing Services, LLC ("Wells Fargo Advisors") for AML charges relating to failure to timely file suspicious activity reports ("SARs").[81]

[80] Complaint, *SEC v. Joseph Salvatore DeVito (a/k/a Salvatore DeVito), et al.*, No. 0:22-cv-60733 (S.D. Fla. April 13, 2022), available here.

[81] *Wells Fargo Clearing Services, LLC*, Exchange Act Release No. 94955, May 20, 2022, available here.

In its Order Instituting Proceedings, the SEC finds that from April 2017 to October 2021, Wells Fargo Advisors failed to timely file at least 34 SARs. The delay in filing at least nine of the SARs allegedly was caused by Wells Fargo Advisors failing to appropriately process wire transfer data into its AML transaction monitoring system, including on dates when there was a bank holiday, yet no corresponding brokerage holiday, which meant the program failed to produce approximately 658 alerts. The SEC finds that these nine SARs ranged from being filed 536 to 1,209 days late. The delay in filing at least 25 other SARs was allegedly caused by Wells Fargo Advisors improperly implementing a new version of its AML transaction monitoring and alert system, which meant the system failed to timely produce alerts for approximately 1,708 brokerage transactions, at least 25 of which required the filing of SARs. The SEC finds that these 25 SARs were filed an average of 157 days late. The SEC finds that the new version of the AML transaction monitoring program failed to properly cross-reference country codes for some countries, which rendered the program incapable of generating alerts for wire transfers involving 58 countries deemed moderate or high risk. The SEC finds that Wells Fargo Advisors did not adequately test or monitor the new version of its program.

Wells Fargo Advisors consented to the entry of the SEC's Order finding that it violated Exchange Act Section 17(a) and Rule 17a-8 thereunder. Without admitting or denying the findings, Wells Fargo Advisors agreed to a cease and desist order, a censure and a civil money penalty of $7 million.

C. Failure to Implement AML Policies*: In re Suzanne Marie Capellini*

FINRA responds to a compliance officer's failure to comply with AML regulations. On June 1, 2022, FINRA announced the initiation of a disciplinary proceeding against Suzanne Marie Capellini ("Capellini"), the Anti-Money Laundering Compliance Officer at First Manhattan Co.[82]

Specifically, FINRA alleges that Capellini failed to develop and implement a reasonable AML program for the firm. The program was inadequate in a number of ways, including, but not limited to: not providing guidance as to how to deal with red flags of potentially suspicious trading activity in microcap securities; failure to describe how First Manhattan should monitor information collected during the pre-clearance process for AML purposes; and utilizing exception reports to identify suspicious conduct, where the exception reports did not display transactions with fewer than 50 million shares and thus did not capture all of the microcap activity during the relevant period. In addition, FINRA alleges that Capellini provided false or misleading information to FINRA when asked to produce due diligence inquiries that it made to determine the free trading basis of microcap securities.

For violations of FINRA Rules 3310(a) and 2010 for failure to implement a reasonable AML program, and for violations of FINRA Rule 8210 and 2010 for providing false or misleading information to FINRA, FINRA is seeking sanctions under FINRA Rule 8310(a), including monetary sanctions, against Capellini.

D. High Risk Investments Improperly Recommended to Retirees and Retail Investors: *SEC v. Western International Securities, Inc., et al.*

Best Interest Obligation regulations ("Reg BI") went into effect in 2020, and the SEC's action against Western International Securities, Inc. ("WIS") and others is the first Reg BI enforcement action. On June 16, 2022, the SEC

[82] *Dep't of Enforcement v. Suzanne Marie Capellini CRD No. 1357703*, FINRA Disciplinary Proceeding No. 2020066627202, June 1, 2022, available here.

announced the filing of a contested injunctive action in the U.S. District Court for the Central District of California against registered broker-deal WIS and five of its registered representatives for violations of Reg BI.[83]

Reg BI established a "best interest" standard of conduct for broker-dealers making recommendations to retail customers, specifically requiring that a broker or dealer comply with four components: the Disclosure Obligation, the Care Obligation, Conflict of Interest Obligation and the Compliance Obligation by exercising reasonable diligence, care and skill in understanding potential risks and rewards of their recommendations.

In its Complaint, the SEC alleges that the Defendants recommended and sold to their retail customers corporate L bonds offered by GWG Holdings, Inc. ("GWG") that were high risk, illiquid and suitable only for those with substantial financial resources. Specifically, the SEC alleges that the Defendants recommended and sold a total of $13.3 million unrated L Bonds to retirees and other investors who were on fixed incomes and had moderate risk tolerances between July of 2020 and April of 2021, and who should only have received recommendations for investments that were low-risk. These customers' investment objectives did not include speculative investments, given that the clients only had limited investment experience. As a result, the SEC alleges that the Defendants did not have a reasonable basis for recommending L Bonds to these customers.

The SEC's Complaint charges Defendants with violating the Best Interest Obligation under Rule 15l-1(a) of the Exchange Act. From each of the Defendants, the Complaint seeks permanent injunctions, disgorgement plus prejudgment interest and civil monetary penalties.

[83] Complaint, *SEC v. Western International Securities, Inc., et al.*, No. 22-cv-04119 (C.D. Cal. June 15, 2022), available here.

Other Enforcement Actions

A. Improper Use of Reserve Account Leads to Misstated Earnings: *In the Matter of Rollins, Inc. and Paul Edward Northen*

The SEC will pursue companies that intentionally adjust reserves to manipulate reported earnings. On April 18, 2022, the SEC announced the filing of settled administrative proceedings against pest control company Rollins, Inc. ("Rollins") and its former Chief Financial Officer Paul Edward Northen for improper accounting practices and for manipulating Rollins' reported earnings.[81]

In its Order Instituting Proceedings, the SEC finds that Rollins and Northen improperly reduced Rollins' accounting reserves in order to allow Rollins to report higher earnings per share. Northen, and other senior finance personnel, allegedly sent reports prior to the end of Rollins' quarterly close process that listed preliminary financial data, including earnings per share. The SEC finds that Northen and others improperly adjusted the levels of reserve accounts, which had the effect of changing Rollins' net income and therefore its earnings per share. By way of example, the SEC finds that in April 2016, after Northen and other personnel discussed that Rollins had unexpectedly low income which was negatively affecting its earnings per share, Northen directed a reduction of $1.3 million from a termite reserve account that was in place to account for damage claims by customers. The Order asserts that the termite reserve reduction and other reserve reductions were inadequately documented and were done without considering any accounting criteria or guidance. The SEC finds that improper reductions caused Rollins to make misstatements of income and earnings per share on its Forms 10-Q and in earnings releases.

The Order finds that Rollins violated Securities Act Sections 17(a)(2) and 17(a)(3), and Exchange Act Sections 13(a), 13(b)(2)(A), 13(b)(2)(B) and Rules 12b-20, 13a-11, 13a-13 and 13a-15(a) thereunder. The Order also finds that Northen violated Securities Act Sections 17(a)(2) and 17(a)(3), as well as Exchange Act Section 13(b)(5) and Rule 13b2-1, and that that Northen caused Rollins' violations of Securities Act Sections 17(a)(2) and 17(a)(3), as well as Exchange Act Sections 13(a), 13(b)(2)(A), and 13(b)(2)(B), and Rules 12b-20, 13a-11, 13a-13 and 13a-15(a) thereunder. Rollins and Northen were ordered to cease and desist from future violations and pay civil money penalties of $8,000,000 and $100,000, respectively.

B. FCPA Violations: *In re Stericycle, Inc.*

Multi-country bribery scheme leads to FCPA and record-keeping enforcement action. On April 20, 2022, the SEC announced the filing of settled administrative proceedings against Stericycle, Inc. ("Stericycle"), a worldwide provider of medical waste management and other services, for violations of the anti-bribery, books and records and internal accounting controls provisions of the Foreign Corrupt Practices Act of 1977 (the "FCPA") arising out of bribery schemes that took place in Argentina, Brazil and Mexico.[85]

In its Order Instituting Proceedings, the SEC finds that from at least 2012 to 2016, Stericycle made hundreds of bribe payments totaling millions of dollars to obtain and maintain business from government customers in Brazil, Mexico and Argentina, as well as to obtain authorization for priority release of payments owed under government contracts. The SEC finds that Stericycle staff allegedly kept and emailed spreadsheets that identified government

[81] *Rollins, Inc., et al.*, Securities Act Release No. 11052, April 18, 2022, available here.

[85] *Stericycle, Inc.*, Exchange Act Release No. 94760, April 20, 2022, available here.

customers who received bribes, and that the bribery scheme also included sham third-party vendors who used false invoices to conceal cash payments to government clients. According to the SEC, the improper payments were not accurately reflected in Stericycle's books and records, and Stericycle failed to maintain sufficient internal accounting controls in place, such as a centralized compliance department, to detect or prevent the misconduct. As a result of these violations, the SEC finds that Stericycle allegedly benefitted by approximately $22.2 million.

Stericycle consented to the SEC's cease-and-desist order that it violated Sections 30A, 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act, and agreed to pay approximately $28.2 million in disgorgement and prejudgment interest. The SEC's Order provided for an offset of up to approximately $4.2 million of any disgorgement paid to Brazilian authorities. Therefore, the company's minimum payment to the SEC would be approximately $24 million. Stericycle must comply with certain undertakings set forth in the Order and also must retain an independent corporate monitor for two years followed by one year of self-reporting.

Also on April 20, 2022, the U.S. Department of Justice announced that Stericycle had entered into a three-year deferred prosecution agreement (DPA) in connection with the filing of a criminal information arising from the same conduct. Pursuant to the DPA, Stericycle's has agreed to pay a criminal penalty of $52.5 million, one third of which will be credited against fines the company pays to authorities in Brazil in related proceedings.

C. Market Manipulation: *In re Archegos, et al.,*

The SEC, CFTC and the DOJ each filed charges against Archegos Capital Management, LP, its principal Bill Hwang and others, in a wide-ranging stock manipulation scheme. On April 27, 2022, the SEC announced the filing of an injunctive action in the U.S. District Court for the Southern District of New York against Sung Kook (Bill) Hwang, the owner of family office, Archegos Capital Management, LP ("Archegos"), for allegedly directing a fraudulent scheme that included interlocking deceptive acts and misconduct, false and misleading statements to security-based swap counterparties and prime brokers and manipulative trading designed to artificially move the market that resulted in billions of dollars in losses.[86] The SEC also charged Archegos' Chief Financial Officer, Patrick Halligan; head trader, William Tomita; and Chief Risk Officer, Scott Becker, for their roles in the fraudulent scheme. Also on April 27, 2022, the U.S. Attorney's Office for the Southern District of New York announced criminal charges against Hwang, Halligan, Becker and Tomita for similar conduct, [87] and the CFTC announced settled charges against Tomita and Becker, and filed charges against Archegos and Halligan.[88]

In its Complaint, the SEC alleges that, from at least March 2020 to March 2021, Hwang purchased on margin billions of dollars of total return swaps, which subjected the family office to significant exposure from rising and falling share prices of the issuers referenced in its swaps. The security-based swaps enabled Archegos to take significant positions in equity securities of certain companies, while only having to post limited funds up front. The SEC alleged that Hwang's trading strategy lacked no economic purpose other than to artificially and dramatically increase the prices of Archegos' top 10 holdings. Such conduct then induced other investors to purchase those securities at inflated prices. The margin and capacity extended by Archegos' counterparties enabled the allegedly manipulative trading.

[86] *SEC Charges Archegos and its Founder with Massive Market Manipulation Scheme*, SEC Press Release No. 2022-70, April 27, 2022, available here; *see* Complaint, *SEC v. Sung Kook (Bill) Hwang, et al.*, No. 22-cv-03402 (S.D.N.Y. April 27, 2022), available here.

[87] *Four Charged In Connection With Multi-Billion Dollar Collapse of Archegos Capital Management* , DOJ Press Release No. 22-138, April 27, 2022, available here.

[88] *CFTC Charges Archegos Capital Management and Three Employees with Scheme to Defraud Resulting in Swap Counterparty Losses over $10 Billion*, CFTC Press Release No. 8520-22, April 27, 2022, available here.

The SEC's complaint also alleges that during the relevant period, despite varying degrees and quality of risk management and proactive questioning by its counterparties, Archegos repeatedly and deliberately misled counterparties about its exposure, concentration and liquidity, in order to obtain increased trading capacity so that Archegos could continue buying swaps in its most concentrated positions, thereby driving up the price of those stocks. The lack of transparency regarding Archegos' position gave counterparties the impression that Archegos' overall positioning was less concentrated and more liquid than it actually was. Ultimately, over the course of less than a week in late March 2021, price declines in Archegos' most concentrated positions allegedly triggered significant margin calls that Archegos was unable to meet. Consequently, Archegos' subsequent default and collapse resulted in billions of dollars in credit losses among Archegos' counterparties, and significant losses to other the market participants who invested in the stocks at inflated prices.

The SEC charged defendants Hwang, Tomita and Archegos Capital Management with violations of Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and Section 9(a)(2) of the Exchange Act. It charged defendants Halligan and Becker with violations of Sections 17(a)(1) and (3) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder. It also charged Halligan with aiding and abetting Becker's violations of Sections 17(a)(1) and (3) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, in violation of Section 15(b) of the Securities Act and Section 20(e) of the Exchange Act. The Complaint seeks permanent injunctive relief, disgorgement of ill-gotten gains plus prejudgment interest, and civil monetary penalties. The SEC also seeks to bar the individual defendants from serving as a public company officer and/or director.

D. FINRA Crowdfunding Portal Actions: *In re Wefunder Portal, LLC* and *In Re StartEngine Capital LLC*

FINRA initiated proceedings against two funding portals for misleading statements associated with crowdfunding efforts pursuant to the 2012 JOBS Act. On May 4, 2022, FINRA accepted Letters of Acceptance, Waiver and Consent ("AWCs") from Wefunder Portal, LLC ("Wefunder") and StartEngine Capital LLC ("StartEngine"), both of which are funding portals that serve as intermediaries for crowdfunding offerings that relied on Securities Act Section 4(a)(6).[89]

As consented to in the AWCs, the 2012 JOBS Act created a new exemption for sales of unregistered securities via funding portals or broker-dealers. Crowdfunding is a way to raise money from a large amount of people via the internet. The Wefunder AWC states that Wefunder is a funding portal that serves as an intermediary for crowdfunding. It finds that Wefunder diverted funds that exceeded the maximum amount permitted by Regulation Crowdfunding ("Reg CF") to separate Regulation D offerings. The AWC also says that Wefunder made prohibited investment recommendations and impermissibly solicited investments — Wefunder sent more than one million emails to hundreds of thousands of customers suggesting or soliciting investments despite Wefunder not being registered as a broker or dealer, and despite Reg CF Rule 402(a) prohibiting crowdfunding intermediaries from offering such advice or soliciting investments. The Wefunder AWC also states that Wefunder made misleading communications on its website and failed to establish and maintain a reasonable supervisory system.

[89] *Wefunder Portal, LLC*, FINRA Letter of Acceptance, Waiver, and Consent No. 2021071940801, May 4, 2022, available here; *StartEngine Capital LLC*, FINRA Letter of Acceptance , Waiver, and Consent No. 2017055183101, May 4, 2022, available here.

The Wefunder AWC finds that Wefunder violated Securities Exchange Act Section 15(a)(1), Reg CF Rules 301(a), 303(e) and 402(a), and FINRA Funding Portal Rules 200(a), 200(c)(2)(A)and 300(a). Wefunder consented to sanctions of a censure, a $1.4 million fine and retaining an independent consultant.

The StartEngine AWC alleges that StartEngine included on its website misleading investment trackers and misleading information from issuers. For each of the offerings on StartEngine's website, StartEngine had a tracker that indicated how many investors had committed funds to that offering. However, StartEngine treated each individual investment as an investor, even if the same investor made more than one investment. The misleading content on StartEngine's website included exaggerated issuer communications regarding the functionality of a home robot produced by the issuer, for which StartEngine acted as an intermediary in a crowdfunding equity offering. Other misleading statements on the StartEngine website included those from another issuer's communications regarding the game schedule for the issuer's new basketball team. The StartEngine AWC states that StartEngine knew or should have known that this information was misleading. Finally, the StartEngine AWC states that StartEngine failed to reasonably supervise the issuer communications on its website.

The StartEngine AWC finds that StartEngine violated FINRA Funding Portal Rules 200(a), 200(c) and 300(a). StartEngine consented to sanctions of a censure and a $350,000 fine, and it agreed to implement new policies and procedures.

E. Inadequate Disclosures Fail to Address Cryptomining Risk: *In re NVIDIA Corporation*

Companies should be mindful of adequately disclosing the drivers of revenue growth in public filings, particularly when associated with emerging technology, such as cryptomining. On May 6, 2022, the SEC announced the filing of settled administrative proceedings against technology company NVIDIA Corporation related to inadequate disclosures that cryptomining significantly drove its revenue growth from the sale of its graphics processing units ("GPUs").[90]

In its Order Instituting Proceedings, the SEC finds that NVIDIA had information that its growth in gaming sales was significantly tied to use of its GPUs for mining cryptocurrencies. However, NVIDIA failed to disclose in two of its fiscal year 2018 Forms 10-Q that cryptomining was a significant factor in its gaming revenue growth. NVIDIA also made statements regarding crypto's effects on other areas of NVIDIA's business, which the Order finds implied that the growth of the gaming business was not driven by cryptomining. The SEC finds that NVIDIA's failure to disclose that earnings and cash flow may be related to cryptomining — which is linked to the volatility of certain crypto assets — inhibited investors' ability to determine whether past performance was indicative of future performance. NVIDIA also failed to maintain adequate disclosure controls and procedures as required by Exchange Act Rule 13a-15(a).

Without admitting or denying the findings, NVIDIA consented to the entry of the SEC's Order finding that NVIDIA violated Sections 17(a)(2) and (3) of the Securities Act and Section 13(a) of the Exchange Act and Rules 12b-20, 13a-13 and 13a-15(a) thereunder. NVIDIA was ordered to cease and desist from future violations and to pay a civil money penalty of $5.5 million.

[90] *NVIDIA Corporation*, Securities Act Release No. 11060, May 6, 2022, available here.

F. Market Manipulation and Foreign Corruption: *In re Glencore International AG, et al.*

Market manipulation and bribery related to the price of fuel oil result in civil and criminal charges from domestic and foreign regulators. On May 24, 2020, the CFTC announced the filing of settled administrative proceedings against Glencore, an energy and commodities trading firm comprising of Glencore International A.G., Glencore Ltd., Chemoil Corporation, and other entities, for engaging in a scheme to manipulate global oil markets.[91]

In its Order Instituting Proceedings, the CFTC finds that from at least 2007 to 2018 Glencore engaged in manipulation and foreign corruption in U.S. and global oil markets with the specific intent to manipulate the price of fuel oil products by manipulating U.S. price-assessment benchmarks relating to physical fuel oil products and derivatives. Glencore's tactics included submitting increasing bids or decreasing offers, which Platts (a London-based price reporting agency) reported to its subscribers, as well as reporting misleading information to Platts to influence Platts' assessment. The Order also states that Glencore's conduct involved bribes and kickbacks to employees and agents of certain state-owned entities in foreign countries in exchange for preferential treatment and access to trades with the state-owned entities.

Glencore consented to the Order, which finds that Glencore violated Sections 6(c)(1), 6(c)(1)(A), 6(c)(3) and 9(a)(2) of the Commodity Exchange Act and CFTC Regulations 180.1 and 180.2. Glencore was ordered to cease and desist and disgorge $321 million and pay a civil monetary penalty of $866 million. Glencore also must comply with further conditions, including retaining independent compliance monitor(s). Glencore was also charged criminally by the Fraud Section of the DOJ's Criminal Division and the U.K. Serious Fraud Office and entered guilty pleas in both actions.[92] Glencore agreed to pay $1.1 billion to resolve the DOJ investigation, and will be sentenced subsequently for the guilty pleas in the SFO investigation.

G. Repeated FCPA Offenses: *In re Tenaris, S.A.*

The SEC charges a steel pipe manufacturer for bribing foreign officials in exchange for business in violation of federal law. On June 2, 2022, the SEC announced the filing of settled administrative proceedings against Tenaris, S.A., a manufacturer and supplier of steel pipe products, for engaging in a scheme to gain business through the use of unauthorized payments to representatives of state-owned entities. The charges related to alleged violations of the Foreign Corrupt Practices Act ("FCPA") in connection with a bribery scheme involving its Brazilian subsidiary, Confab Industrial S.A., to secure business opportunities from Brazilian state-owned Petrobas.[93]

In its Order Instituting Proceedings, the SEC finds that between 2008 and 2013, Tenaris paid approximately $10.4 million in bribes to a Brazilian government official in exchange for that official using his authority to influence Petrobas to favor Confab and forgo the tender process for certain pipes and tubes contracts. As a result of the scheme, Confab earned over $1 billion dollars' worth of business from Petrobas. In 2011, Tenaris previously entered into a Non-Prosecution Agreement with the U.S. Department of Justice, and a Deferred Prosecution Agreement with the SEC, to resolve charges arising from a bribery scheme involving another state-owned entity.

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[91] *CFTC Orders Glencore to Pay $1.186 Billion for Manipulation and Corruption*, CFTC Release No. 8534-22, May 24, 2022, available here.

[92] *Glencore Entered Guilty Pleas to Foreign Bribery and Market Manipulation Schemes*, DOJ Press Release No. 22-554, May 24, 2022, available here; *Serious Fraud Office Secures Glencore Conviction on Seven Counts of International Bribery*, U.K. Serious Fraud Office Press Release, June 21, 2022, available here.

[93] *Tenaris S.A.*, Exchange Act Release No. 95030, June 2, 2022, available here.

Tenaris consented to the SEC's Order without admitting or denying the SEC's findings and agreed, and agreed to pay more than $78 million dollars in combined monetary sanctions, including disgorgement in the amount of $43 million, prejudgment interest of $10 million and a civil monetary penalty of $25 million.

H. Software Company Charged with Accounting Errors: *In re Synchronoss Technologies, Inc.*

Inaccurate financial reporting and accounting improprieties led to settled and contested actions from the SEC against Synchronoss and a number of former and current employees. On June 7, 2022, the SEC announced the filing of settled administrative proceedings and contested injunctive proceedings against Synchronoss Technologies, Inc. ("SNCR"), and seven senior employees, including the former CFO, for their respective roles related to alleged long-running accounting improprieties that ran from 2013 to 2017.[94]

In its Orders Instituting Proceedings against Synchronoss and defendants Ronald Prague (former general counsel), Clayton (Charlie) Thomas, Marc Bandini and Daniel Ives (former employees) and John Murdock (current employee), the SEC found that certain of SNCR's senior executives and other employees caused SNCR to backdate agreements and misrepresent the status of negotiations, which resulted in materially misstated financial statements. SNCR restated its audited financial statements for the fiscal years ending Dec. 31, 2015 and 2016, and selected financial data for the fiscal years ending 2013 and 2014. As found by the SEC, the restatements disclosed that SNCR improperly recognized revenue related to: (1) transactions that either did not materialize or were not likely to materialize, (2) license agreements that were part and parcel of an acquisition/divestiture instead of combining those amounts in the purchase/sale amounts and (3) license/hosting transactions that should have been recognized ratably over the term of the agreements. The company's former general counsel settled charges that he misled auditors regarding two of the transactions at issue. Other former senior employees and current employees were charged with participating in the "side-letter" agreements that allegedly concealed revenue.

The SEC's Order found that Synchronoss and its executives violated Section 10(b) of the Exchange Act and Rules 10b-5(a) and 10b-5(c) thereunder; Section 13(a) of the Exchange Act and Rules 13a-1, 13a-11, 13a-13 and 12b-20 thereunder; and Sections 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act. The SEC also ordered SNCR to pay a civil monetary penalty in the amount of $12.5 million. The former general counsel agreed to pay a civil monetary penalty in the amount of $25,000 and to be suspended from appearing and practicing before the SEC as an attorney. The other employees individually paid civil penalties ranging from the amount of $15,000 to $90,000. Further, SNCR's former CEO, Stephen Waldis, while not charged, agreed to reimburse SNCR for over $1.3 million dollars in profits from stock sales and bonuses.

Also on June 7, 2022, the SEC filed a civil action for injunctive relief in the U.S. District Court for the Southern District of New York, against two certified public accountants, former CFO Karen Rosenberger and former Controller Joanna Lanni, arising from the same long-running improper accounting scheme. In its Complaint, the SEC charged Rosenberger with violating Sections 10(b), 13(a) and 13(b)(5) of the Exchange Act and Rules 10b-5, 13a-14, 13b2-1 and 13b2-2 promulgated thereunder; and Section 304 of the Sarbanes-Oxley Act. It also charged Rosenberger with aiding and abetting Synchronoss' violations of Sections 10(b), 13(a), 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act and Rules 10b-5, 12b-20, 13a-1, 13a-11 and 13a-13 thereunder. The SEC charged Lanni with violating Section 13(b)(5) of the Exchange Act and aiding and abetting Synchronoss' violations of Sections 13(a) and 13(b)(2)(A) of the Exchange Act and Rules 12b-20, 13a-1, 13a-11 and 13a-13 thereunder.

[94] *Synchronoss Technologies, Inc.*, Exchange Act Release No. 95049, June 7, 2022, available here.

I. Audit Firm Settles Allegations of Ethics Violations: *In re Ernst & Young LLP*

The SEC imposes a historic penalty against Big Four accounting firm for multi-year ethics violations. On June 28, 2022, the SEC announced the filing of settled administrative proceedings against Ernst & Young LLP ("EY") for ethics violations relating to allegations that certain EY employees cheated on the ethics component of the CPA exam.[95] Of some significance, EY admitted to the findings in the SEC's Order.

In its Order Instituting Proceedings, the SEC found that EY failed to act with the integrity required of a public company auditor because a significant number of its audit professionals allegedly cheated on the ethics component of the CPA exam as well as other exams required to maintain their professional licenses. The SEC found that multiple EY audit professionals, over the course of several years, engaged in the cheating scandal. Additionally, many professionals not engaged in cheating themselves facilitated cheating by sharing answers, in violation of the law as well as EY's code of conduct.

Further, the SEC found that EY made material and misleading misrepresentations to the SEC about the testing improprieties when the SEC began its investigation. Specifically, EY told the SEC that EY was not aware of any cheating allegations despite having already been made aware of potential improprieties in connection with the CPA exam.

The SEC's Order found that EY violated Public Company Accounting Oversight Board Rule 3500T, which requires compliance with ethics standards, including American Institute of Certified Public Accountants' Code of Professional Conduct 1.400.0001. In addition, the SEC found that EY violated Section 4C(a)(3) of the Exchange Act and Rule 102(e)(1)(iii) of the Commission's Rules of Practice. As a result of these violations, the SEC ordered that EY undertake certain enumerated actions in the Order, including an evaluation of its policies and procedures within 120 days of the entry of the Order, and ordered the payment of a civil monetary penalty of $100 million dollars.

J. Multiple Cryptocurrency-Related Fraud Indictments: *United States v. Le Ahn Tuan*; *United States v. Emerson Pires, et al.*; *United States v. Michael Alan Stollery*; *and United States v. David Saffron*

On June 30, 2022, the Department of Justice ("DOJ") announced criminal charges for alleged cryptocurrency-related fraud in four separate cases against six defendants.[96]

- The DOJ filed an action against Le Ahn Tuan ("Tuan"), a 26-year-old Vietnamese citizen, in the U.S. District Court for the Central District of California for wire fraud and conspiracy to commit international money laundering.[97] Specifically, the complaint alleges that Tuan, who was a member of the Baller Ape Club, an NFT investment project selling NFTs in the form of cartoon-like characters, engaged in a "rug pull" in which — the day after the Club's NFTs were publicly sold — Tuan and his co-conspirators shut down the website, ending the project, and stealing the investor's money in the amount of $2.6 million dollars. They then allegedly laundered the stolen funds by converting the money to a different type of cryptocurrency or coin

[95] *Ernst & Young LLP*, Exchange Act Release No. 95167, June 28, 2022, available here.

[96] *Justice Department Announces Enforcement Action Charging Six Individuals with Cryptocurrency Fraud Offenses in Cases Involving Over $100 Million in Intended Losses*, DOJ Press Release, No. 22-692, June 30, 2022, available here.

[97] Indictment, *United States v. Le Ahn Tuan*, No. 22-CR-273 (C.D. Cal. June 28, 2022), available here.

and then moving it across multiple blockchains, obscuring the trail of the funds by using decentralized cryptocurrency swap services. Tuan faces up to 30 years in prison.

- The DOJ filed an indictment against Emerson Pires, Flavio Goncalves and Joshua David Nicholas in U.S. District Court for the Southern District of Florida for conspiracy to commit wire fraud, conspiracy to commit securities fraud and conspiracy to commit international money laundering in connection with a global cryptocurrency Ponzi scheme.[98] The indictment alleges that these individuals founded a cryptocurrency investment platform called EmpiresX, which they then fraudulently promoted by misrepresenting the use of a proprietary trading bot as well as fraudulently guaranteeing returns among other illegal acts. Ultimately, the defendants were able to gather $100 million from investors, which they allegedly laundered using foreign-based cryptocurrency exchanges. If convicted, the defendants face up to 45 years in prison. The SEC also filed related civil fraud charges against EmpiresX, Pires, Goncalves and Nicholas.[99]

- The DOJ filed an indictment in federal court in California against Michael Alan Stollery, CEO and founder of Titanium Blockchain Infrastructure Services ("TBIS") for one count of securities fraud in connection with a cryptocurrency fraud scheme involving TBIS's initial coin offering, which raised about $21 million dollars from investors around the world.[100] The alleged scheme involved a falsified white paper about the coin technology, posting fake testimonials on TBIS's website as well as falsely representing a business relationship with the U.S. Federal Reserve Board and other major companies, which included Apple Inc. and Pfizer Inc. If convicted, Stollery faces up to 20 years in prison. The DOJ's charges follow a related 2018 SEC civil action against Stollery and TBIS.[101]

- Lastly, the DOJ filed an indictment in federal court in California against David Saffron for conspiracy to commit wire fraud, wire fraud, conspiracy to commit commodities fraud and obstruction of justice in connection with his creation of an unregistered commodity pool called Circle Society.[102] Saffron allegedly made false representations to investors that he used a proprietary bot to trade investments to earn profits in cryptocurrency exchanges to the tune of 500 percent to 600 percent returns on investment. To create the appearance of legitimacy, he threw gatherings in luxury homes in California and traveled with armed security. Saffron raised approximately $12 million dollars from investors, and if convicted, faces up to 115 years in prison.

[98] *Three Men Charged in $100 Million Cryptocurrency Fraud*, DOJ Press Release, June 30, 2022, available here.

[99] Complaint, *SEC v. Empires Consulting Corp., et al.*, No. 22-cv-21995 (S.D. Fla. June 30, 2022), available here.

[100] Indictment, *United States v. Stollery,* No. 22-cr-207 (C.D. Cal. May 13, 2022), available here.

[101] *SEC Obtains Preliminary Injunction in Fraudulent Coin Offering Scheme*, SEC Litigation Release No. 24160, June 7, 2018, available here.

[102] Indictment, *United States v. Saffron*, No. 22-cr-276 (C.D. Cal. June 28, 2022), available here.

About Schulte Roth & Zabel

SRZ's Securities Enforcement Group represents public and private companies, financial institutions, broker-dealers, private funds and their senior executives in securities-related enforcement proceedings and government investigations involving the full range of federal and state law enforcement and regulatory authorities. With numerous former federal prosecutors from U.S. Attorneys' offices, including chiefs of the Appeals and Major Crimes Units, and former SEC officials, our deep bench of lawyers offers guidance on matters ranging from informal inquiries and formal or grand jury investigations to administrative proceedings and cases brought in federal and state courts.

SRZ lawyers are available to assist in addressing any questions you may have regarding these developments. Please contact the SRZ lawyer with whom you usually work, the authors, or any of the following members of the Securities Enforcement practice group:

Charles J. Clark
Co-Chair, Securities Enforcement
+1 202.729.7480 | charles.clark@srz.com

Craig S. Warkol
Co-Chair, Securities Enforcement
+1 212.756.2496 | craig.warkol@srz.com

Harry S. Davis
+1 212.756.2222 | harry.davis@srz.com

Marc E. Elovitz
+1 212.756.2553 | marc.elovitz@srz.com

Taleah E. Jennings
+1 212.756.2454 | taleah.jennings@srz.com

Gayle R. Klein
+1 212.756.2409 | gayle.klein@srz.com

Douglas I. Koff
+1 212.756.2773 | douglas.koff@srz.com

Kelly Koscuiszka
+1 212.756.2465 | kelly.koscuiszka@srz.com

Martin L. Perschetz
+1 212.756.2247 | martin.perschetz@srz.com

Betty Santangelo
+1 212.756.2587 | betty.santangelo@srz.com

Howard Schiffman
+1 212.756.2733 | howard.schiffman@srz.com

Gary Stein
+1 212.756.2441 | gary.stein@srz.com

Michael E. Swartz
+1 212.756.2471| michael.swartz@srz.com

Peter H. White
+1 212.756.2413| pete.white@srz.com

The following SRZ lawyers assisted in preparing this client update: Shannon B. Wolf (Editor), H. Spencer Busby, Toni Deane, Benjamin Lewson, Nathaniel Palmer, J. Eric Prather, Jeffrey Robertson, Frances Rodriguez and Hamdi Soysal.

Schulte Roth & Zabel
New York | Washington DC | London
www.srz.com