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Quarterly Survey of SEC Rulemaking and Major Appellate Decisions (July 1, 2021–September 30, 2021)

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This issue's Survey focuses on the U.S. Securities and Exchange Commission's ("SEC") rulemaking activities and other decisions relating to the Securities Act of 1933, as amended (the "1933 Act"), the Securities Exchange Act of 1934, as amended (the "1934 Act"), and other federal securities laws from July 1, 2021 through September 30, 2021.

The SEC finalized two new, technical rules for implementation, and proposed one new rule for this quarter. Due to new leadership at the SEC, there has been a lack of rulemaking during this quarter. Gary Gensler was sworn into office as the Chair of the SEC on April 17, 2021. The SEC's new administration has been undergoing a rigorous review of current SEC rules and policies.

With the lack of rulemaking this quarter, this article will discuss the SEC's increased interest in regulating cryptocurrency, as well as the recent Nasdaq rule regarding board of director diversity which was approved by the SEC.

Cryptocurrency Regulation

SEC Chair Gensler has given numerous indications in this past quarter that the SEC is examining cryptocurrency markets and the role of government in regulating them. Through several public addresses and interviews, Gensler, who spent time at the Massachusetts Institute of Technology teaching courses on crypto finance, blockchain technology and other innovations in the fintech space, appears to be laying the groundwork for forthcoming regulatory action. In remarks at the Aspen Security Forum, Gensler spoke positively of the technological innovations underlying cryptocurrency, but warned that it was an asset class "rife with fraud, scams, and abuse," reflecting the SEC's concern that crypto markets may prey on investors with little or no access to information on the tokens they invest in.[1]

In addition, Chair Gensler has indicated a desire to see further

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legislation from Congress to address existing regulatory inadequacies as related to cryptocurrency markets. Though the SEC has taken the position that crypto tokens are securities within the purview of the SEC's existing mandate, there are other related products like stable coins (a type of cryptocurrency whose value is pegged to a more known asset like a fiat currency, a commodity or another cryptocurrency) that may occupy regulatory gaps. Other products like Coinbase's "Lend" program have also attracted SEC attention. The recent public dispute between the SEC and Coinbase has given this issue great public exposure. Following receipt of a Wells Notice from the SEC, Coinbase went public with its frustration at the lack of regulatory clarity, claiming that the SEC had never bothered to explain its position on Coinbase's planned "Lend" program despite engagement from Coinbase.[2] The program would have allowed Coinbase customers to earn interest by lending certain of their tokens on Coinbase. Though Coinbase took the position that the "Lend" program did not qualify as a security, it soon dropped the product in the face of SEC opposition. For its part, the SEC is working on a report on stable coins which may address some of these gaps and invite further action, perhaps in concert with banking and commodity regulators as well.[3]

Lastly, the SEC has indicated that Bitcoin mining may come under increasing scrutiny as part of the SEC's new focus on climate risk disclosure. The SEC is widely expected to release new rule proposals in the fourth quarter of 2021 mandating more corporate reporting on a public company's impact on climate change. Bitcoin mining, the process by which new coins are generated as compensation for the first users to solve a highly complex computational problem, is highly energy-intensive. Cryptocurrencies incentivize mining activities because they function as a decentralized means of verifying blockchain transactions. Companies (or individuals) that mine cryptocurrency (including Bitcoin) require advanced computing equipment with immense processing power, which in turn requires substantial electric power to run. It remains to be seen the extent to which the SEC's broader initiative for greater disclosure of climate risk to investors will affect cryptocurrencies, but there are strong indications that mining activities will be continue to receive greater scrutiny in near the future.

Nasdaq Rule to Diversify Company's Board of Directors

On August 6, 2021, the SEC approved Nasdaq's board diversity rule, which requires Nasdaq-listed companies to have at least two diverse board members or else explain their failure to meet

the requirement, with some exceptions (the "Board Diversity Rule"). To satisfy the Board Diversity Rule, Nasdaq-listed companies must have at least one director that self-identifies as a female and at least one director who self-identifies as an underrepresented racial or ethnic minority or as LGBTQ+. The rule is intended to increase transparency, providing investors with more information on a company's board of directors because the Board Diversity Rule requires that companies publish statistics on the diversity of its directors.

The Board Diversity Rule is not a mandate, but it requires Nasdaq-listed companies that do not have at least one director that self-identifies as female and at least one director who self-identifies as an underrepresented racial or ethnic minority or as LGBTQ+ provide a written explanation for its failure to meet such diversity goals. Subject to the applicable transition period, the written explanation must be provided in advance of the company's next annual shareholders meeting in either a proxy statement, an annual report on Form 10-K or Form 20-F, or on the company's website. If the company provides such written explanation on its website, the company must also submit the explanation to the Nasdaq Listing Center no later than 15 calendar days after the company's annual shareholders meeting. However, Nasdaq and the SEC will not evaluate the substance or merits of the company's written explanation for its failure to meet the diversity goals.

Exceptions to Board Diversity Rule

There are a few exceptions to the Board Diversity Rule. Foreign issuers are only required to have at least one diverse director who is female and another director who is female, LGBTQ+ or a member of an underrepresented community in the context of the country of the company's principal executive offices, which means that a director may be considered racially or ethnically diverse in the foreign company's home country even if such director would not be considered diverse in the United States. Also, smaller reporting companies are required to have two diverse directors, so long as one director self-identifies as female. Thus, a smaller reporting company can satisfy the Board Diversity Rule by having two female directors. Finally, a company with five or fewer directors is only required to have one director who is diverse. Even though these companies fall under an exception to the Board Diversity Rule, these companies must explain their failure to comply with the Board Diversity Rule if the company does not fully comply with the rule.

Exemptions from Board Diversity Rule

There are also certain issuers that are exempt from the Board

Diversity Rule, including acquisition companies, asset-backed and other passive issuers, cooperatives, limited partnerships, management investment companies, issuers of non-voting preferred securities, debt securities and derivative securities that do not have equity securities listed on Nasdaq, and issuers of securities listed under the Nasdaq Rule 5700 Series.

Transition Periods

The new Nasdaq rule specifies a number of deadlines for compliance. Companies listed on the Nasdaq Global Select Market, the Nasdaq Global Market and the Nasdaq Capital Market must have, or explain why they do not have, at least one diverse director by the later of August 6, 2023 or the date the company files its proxy statement or annual report during 2023. Companies listed on the Nasdaq Global Select Market or the Nasdaq Global Market must have, or explain why they do not have, at least two diverse directors by the later of August 6, 2025 or the date the company files its proxy statement or annual report during 2025. Companies listed on the Nasdaq Capital Market must have, or explain why they do not have, at least two diverse directors by the later of August 6, 2026 or the date the company files its proxy statement or annual report during 2026. The Board Diversity Rule also allows newly listed Nasdaq companies certain phase-in compliance periods depending on which of the Nasdaq markets the company is listed.

In addition to the Board Diversity Rule, Nasdaq-listed companies must disclose statistics on the demographics of each of its directors. Companies will be required to disclose the number of its directors that are male, female, non-binary, or that refuse to disclose their gender, as well as the same gender-based statistics broken down by race and ethnicity. Companies are required to comply with this disclosure requirement by the earlier of August 6, 2022 or before the date the company files its proxy statement or annual report.

According to Nasdaq, the Board Diversity Rule promotes diversity in company leadership while maintaining companies' flexibility to choose its leaders, including preserving a company's choice to not select any diverse leaders. Nasdaq hopes that the Board Diversity Rule will increase corporate board diversity.

SEC Fines App Analytics Provider $10M for Touting False Data Usage

On September 14, 2021, the SEC issued a $10M fine to App Annie and a $300,000 to App Annie's former CEO, Bertrand Schmitt, for misleading App Annie's subscribers about how App Annie generated its data and estimates that the subscribers

relied upon in violation of Section 10(b) of the Exchange Act and Rule 10b-5.

App Annie offers a free analytics product, "Connect" to its subscribers, which are often other companies with their own company-specific app. Connect tracks how many times the company's own app is downloaded, the revenue generated through the app, and how company's customers use the app. This type of information is referred to as "alternative data" because it is not found within a company's financial statement. However, alternative data is critical to these companies because investors often use alternative data to inform investment decisions.

In order for Connect to work, the subscriber-company must allow App Annie access to collect "confidential app performance metrics." App Annie then uses those metrics to generate an estimate of app performance in various industries and app categories. Critically, App Annie assured the subscriber-company that the company's metrics will be "aggregated and anonymized." Once App Annie generates estimates, it then sells those estimates to other entities, often trading firms, through its product "Intelligence." However, App Annie was not in fact aggregating and anonymizing the metrics, and was instead using the subscriber-company's data in raw form, essentially matching the subscriber-company's actual existing performance. In turn, App Annie then touted how closely its categorical estimates correlated with individual company's public metrics and performance. Trading firms relied on Intelligence estimates when buying and selling securities.

App Annie further misrepresented that it had controls in place to comply with federal securities laws and prevent the misuse of the subscriber-companies confidential metrics. In particular, Schmitt represented that App Annie's estimates did not include "material nonpublic information" under federal securities laws and App Annie had internal controls in place to prevent MNPI from being used in its statistical model used to generate estimates. The SEC found this was false, and App Annie in fact misused raw data to form its estimates. App Annie also used subscriber-companies' MNPI to manually altered its estimates to match actual app performance to continue to advertise App Annie's accuracy to trading firms.

In the Matter of App Annie Inc. and Bertrand Schmitt (A.P. File No. 3-20549).

United States District Court for the District of New Jersey Denies Allergan's Motion to Dismiss Shareholder Price-Fixing Lawsuit

On September 30, 2021, U.S. District Judge Katharine S.

Hayden denied Allergan's motion to dismiss a shareholder lawsuit alleging generic-drug price fixing and market allocation in violation of Sections 10(b), 14(a) and 20(a) of the Exchange Act and Sections 11, 12, and 15 of the Securities Act. Allergan moved to dismiss on the grounds the claims were not timely and also failed to satisfy the pleading requirements of the Private Securities Litigation Reform Act of 1995 (the "PSLRA").

Beginning in late 2013, various public organizations and government agencies, including a number of congressional officials, began an investigation into price increases for generic drugs throughout the pharmaceutical industry. As part of the investigation, several generic pharmaceutical companies and their executives received subpoenas from the Department of Justice. On November 3, 2016, it was reported that the DOJ was "bearing down" on certain companies, including Allergan. Allergan allegedly participated in "market share allocation," which seeks to control the number of competitors in a market and their timing to enter the market, so each competitor has an acceptable market share, and "anticompetitive price inflation," allowing the company to raise their prices without competing with the other market participants.

With respect to the timeliness of the claims, Allergan argued that the plaintiffs' securities claims were outside the one-year statute of limitations because they were put on notice when it was made public that Allergan received a DOJ subpoena in August 2015. Allergan also claimed that other antitrust lawsuits initiated before plaintiffs concern similar underlying facts. The Court dismissed Allergan's argument because the subpoena announcement would not lead a reasonable investor to conclude there had been fraud and Allergan failed to securities law violation lawsuit prior to November 3, 2016.

With respect to the sufficiency of plaintiffs' market-allocation pleadings, the Court found that plaintiffs satisfied the heighted PLSRA standard to "state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind." Here, the Court found there was sufficient facts to support an inference of scienter based on the extraordinary price increases and a "core operations" inference. The extent of the price increases supports that management was aware of the price-fixing scheme. A "core operations" inference imputes scienter on individual defendants where the price-fixing was applied to Allergan's "key products." There were also numerous allegations concerning communications by phone and text between Allergan executives and the alleged co-conspirators (other competing pharmaceutical companies). The Court also gave weight to the ongoing DOJ investigations to support an inference of scienter.

TIAA-CREF Large-Cap Growth Fund et al. v. Allergan PLC et al., Civ. No. 2:17-cv-11089 (D.N.J. Sept. 30, 2021).

NOTES:

[1]Gary Gensler, Remarks Before the Aspen Security Forum, August 3, 2021. https://www.sec.gov/news/public-statement/gensler-aspen-security-forum-2021-08-03.

[2]Paul Grewal, Coinbase Chief Legal Officer, September 7, 2021. https://blog.coinbase.com/the-sec-has-told-us-it-wants-to-sue-us-over-lend-we-have-no-idea-why-a3a1b6507009.

[3]See e.g., Chairman Gensler's interview with David Ignatius of the Washington Post, September 21, 2021. https://www.washingtonpost.com/washington-post-live/2021/09/21/transcript-path-forward-cryptocurrency-with-gary-gensler/.