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Quarterly Survey of SEC Rulemaking and Major Appellate Decisions (October 1, 2021–December 31, 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 October 1, 2021 through December 31, 2021.

The SEC under Chair Gensler appears to be hitting its stride, finalizing five new rules for implementation and proposing ten new rules this quarter. Most of the SEC's rulemaking activity occurred late in the quarter, with most of the proposed rules that are discussed in this article released following the SEC's Open Meeting that took place on December 15, 2021. The proposed rules that were released following the Open Meeting focus on adding additional disclosure requirements related to securities transactions involving insiders and related policies and procedures.

Proposed Rules

Rule 10b5-1 and Insider Trading

On December 15, 2021, the SEC proposed amendments to Rule 10b5-1, which provides corporate insiders an affirmative defense to insider trading liability in circumstances where, subject to certain conditions, a trade was conducted pursuant to (i) a binding contract, (ii) instructions from another person to execute a trade for the instructing person's account or (iii) a written plan, in each case provided that such actions were taken when the insider was not aware of material nonpublic information. The proposed amendments to Rule 10b5-1 are designed to add new conditions to the availability of Rule 10b5-1 and would require enhanced disclosure.

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New Conditions to the Availability of Rule 10b5-1(c)(1)

Rule 10b5-1(c) establishes an affirmative defense to Rule 10b-5 liability for insider trading in circumstances where it is apparent that the trading was not made on the basis of material nonpublic information because the trade was pursuant to a binding contract, an instruction to another person to execute the trade for the instructing person's account or a written plan adopted when the trader was not aware of material nonpublic information. Since the adoption of Rule 10b5-1, there has been concern that the affirmative defense under Rule 10b5-1(c)(1)(i) has allowed traders to take advantage of the liability protections provided by the rule to opportunistically trade securities on the basis of material nonpublic information. There has also been concern that issuers abuse Rule 10b5-1(c)(1) plans to conduct share repurchases to boost the price of the issuer's stock before sales by corporate insiders.

To address these concerns and others related to Rule 10b5-1(c), the SEC proposed various amendments to Rule 10b5-1. Currently, Rule 10b5-1(c)(1) does not impose any waiting period between the date the trading arrangement is adopted and the date of the first transaction made thereunder, though best practices guidelines include at least a 30-day cooling-off period. The SEC has proposed the introduction of such waiting periods. The proposed rules would require that a Rule 10b5-1 trading arrangement entered into by officers or directors include a 120-day mandatory cooling-off period before any trading can commence following the trading arrangement's adoption, which also includes adoption of a modified trading arrangement for an existing plan. In addition, the SEC proposed a 30-day mandatory cooling off period for a 10b5-1 trading arrangement entered into by issuers before any trading can commence following the trading arrangement's adoption, which also includes adoption of a modified trading arrangement for an existing plan.

In addition, the proposed amendments include that the affirmative defense under Rule 10b5-1(c)(1) does not apply to overlapping Rule 10b5-1 trading arrangements for open market trades in the same class of securities and limits the availability of the affirmative defense under Rule 10b5-1(c)(1) for a single trade to one trade plan during any consecutive 12-month period.

Enhanced Disclosures

Currently, there are no mandatory disclosure requirements concerning the use of Rule 10b5-1 trading arrangements or other trading arrangements by companies or insiders. The SEC has expressed concern that the lack of disclosure deprives investors of the ability to assess whether those parties may be misusing their access to material nonpublic information. The SEC believes that more robust disclosure of particular trading arrangements and insider trading policies or procedures should reduce potential abuse and provide more transparency related to such arrangements and policies.

Such enhanced disclosures proposed by the SEC include a requirement for an issuer to disclose in its annual report whether the issuer has adopted insider trading policies and procedures, and if not, disclose why such issuer has not adopted such policy. Issuers would be required to disclose their insider trading policies and procedures if they have adopted such policies and procedures. Issuers would also be required to disclose in their annual reports their option grant policies and practices, and provide tabular disclosure showing grants made within 14 days of the release of material nonpublic information as well as the market price of the underlying securities on the trading day before and after the release of such information.

In addition, issuers would be required to disclose in their quarterly reports the adoption and termination of Rule 10b5-1 trading arrangements and other trading arrangements by directors, officers and issuers. The enhanced disclosures also provide for amending Forms 4 and 5 to add a check box whereby Section 16 officers and directors will need to indicate whether a reported transaction was made pursuant to a 10b5-1(c) trading arrangement. Finally, the proposed amendments would require Section 16 corporate insiders to disclose bona fide gifts of securities on Form 4 rather than on Form 5, which filing is due within 45 days following the end of an issuer's fiscal year.

The comment period will expire 45 days after publication of the proposed rules in the Federal Register.

Modernization of Share Repurchase Disclosure

On December 15, 2021, the SEC proposed amendments to its rules regarding disclosure about share repurchases of an issuer's equity securities that are registered under Section 12 of the 1934 Act. The proposed amendments are designed to require an issuer to provide more timely disclosure and enhance the existing periodic disclosure requirements about such purchases that are required to be disclosed in Form 10-K and Form 10-Q for domestic issuers, Form 20-F for foreign filers and Form N-CSR for registered closed-end funds.

Issuers may decide to repurchase their shares at prevailing market prices for a variety of reasons, including to return capital to shareholders, to indicate to the market that the issuer believes its equity is undervalued or to improve certain key financial metrics of the issuer like earnings per share (EPS). Critics of buybacks often focus on their use to boost financial performance, because improving such performance may correlate with increased executive compensation. As a result, buybacks are already subject to existing disclosure obligations, including pursuant to Item 703 of Regulation S-K, and under stock exchange continued listing standards.

Proposed Form SR

The SEC's release proposes the creation of a new Form SR that would require issuers to report any purchase made by or on behalf of the issuer or any affiliated purchaser of shares (or units) of the issuer's equity securities registered pursuant to Section 12 of the 1934 Act. The Form SR would require disclosure in tabular format of the following:

1) Class of securities purchased;
2) Total number of shares purchased, including all issuer repurchases, regardless of whether made pursuant to publicly announced repurchase plans;
3) Average price paid per share;
4) Aggregate total number of shares purchased on the open market;
5) Aggregate total number of shares purchased in reliance on the non-exclusive Rule 10b-18 safe harbor; and
6) Aggregate total number of shares purchased pursuant to a plan that is intended to satisfy the affirmative defense of Rule 10b5-1(c).

Form SR would be due no later than one business day following the execution of the applicable repurchases, and would be furnished, not filed, and therefore not subject to liability under Section 18 of the Exchange Act or Section 11 of the Securities Act, unless the issuer expressly incorporated by reference such information. The SEC believes the short deadline for disclosure of such repurchase activity would correct information asymmetries that may exist between issuers and investors given that Item 703 disclosures are not a Form 8-K disclosure item and are only required to appear in quarterly and annual reports. The SEC intends that Form SR would allow investors to use this more immediate disclosure "to monitor and evaluate issuer share repurchases, and their effects on the market for the issuer's securities."

Enhanced Periodic Reporting

In addition to the introduction of Form SR, the SEC is proposing amendments to Item 703 of Regulation S-K (and corresponding changes to Form 20-F and Form N-CSR) to require additional disclosure regarding share repurchases. In particular, the proposal would require an issuer to disclose:

1) The objective or rationale for its share repurchases and process or criteria used to determine the amount of repurchases;
2) Any policies and procedures relating to purchases and sales of the issuer's securities by its officers and directors during a repurchase program, including any restriction on such transactions;
3) Whether it made its repurchases pursuant to a plan that is intended to satisfy the affirmative defense conditions of Rule 10b5-1(c), and if so, the date that the plan was adopted or terminated; and
4) Whether purchases were made in reliance on the Rule 10b-18 non-exclusive safe harbor.

Furthermore, if any of the issuer's Section 16 officers or directors buy or sell any shares of the issue's equity of the same class that is the subject of an issuer share repurchase plan within 10 business days prior to or following the announcement of an issuer purchase plan, the issuer will be required to check an applicable box above the Item 703 share repurchase table in periodic reports.

The SEC is seeking comment on both the content and timing requirements set forth in the proposing release, including as to whether new Form SR should be created or whether existing periodic reporting requirements (e.g. on Form 10-Q) could be updated to address the SEC's concerns. Comments will be due 45 days from the publication of the proposed rule in the Federal Register.

Prohibition Against Fraud, Manipulation or Deception in Connection with Security-Based Swaps

On December 15, 2021, the SEC proposed rules under the 1934 Act to (i) prevent fraud, manipulation, and deception in connection with security-based swap ("SBS") transactions, (ii) prohibit undue influence over Chief Compliance Officers ("CCOs") of a SBS dealer or a majority SBS participant and (iii) require any person with a SBS position that exceeds a certain threshold promptly file with the SEC certain information related to its position.

Re-proposed Rule 9j-1

In 2010, the SEC had attempted to amend Rule 9j-1, which deals with anti-fraud and anti-manipulation in connection with SBS transactions. However, after receiving many comments on the 2010 proposal, the SEC decided to not adopt the 2010 proposed amendments. Recently, the SEC decided to re-propose amendments to Rule 9j-1.

The newly proposed rules follow the same general approach as the 2010 proposal albeit with some differences. Both the 2010 proposal and the newly proposed rules prohibit similar categories of misconduct (including specific types of fraudulent, manipulative, or deceptive conduct in connection with SBS transactions). However, compared to the 2010 proposal, the new rules are broader in that they also prohibit attempted violation in many respects. The new rules also include a provision that prohibits any person from, directly or indirectly, manipulating or attempting to manipulate the price or valuation of any SBS transaction or any payment or delivery related to that SBS transaction.

As drafted, the new rules would also make it unlawful to purchase, sell, effect any transaction in, exercise any right under, terminate or settle any SBS, if such person (1) employs any device, scheme, or artifice to defraud or manipulate; or (2) makes any untrue statement of a material fact, or omits to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading; or (3) obtains money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading; or (4) engages in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person. While (1) and (2) require scienter, (3) and (4) can be satisfied with a showing of negligence. Furthermore, the new rules provide that any attempt at the above acts can also be considered a violation of the rules.

Though the new rules rely on existing statutory language, they are broader in scope. For instance, they would apply not only in connection with the purchase or sale of an SBS but also in connection with the exercise of any right or performance of any obligation under SBS.

In the proposed rules release, the SEC also lists specific conduct that would be prohibited including, but not limited to, the purchase or sale of an SBS while in possession of material nonpublic information with respect to the security underlying such swap. The SEC makes clear that a person cannot avoid liability for trading based on possession of material non-public information about a security by purchasing or selling a SBS based on that security and cannot escape liability under the new rules by purchasing or selling the underlying security (as opposed to purchasing or selling an SBS that is based on that security).

Despite the broader nature of the new rules, the SEC set forth two safe harbor provisions that would apply in circumstances where actions are taken in accordance with binding contractual obligations and portfolio compression exercises (bilateral and multilateral).

Lastly, the SEC recognizes fraudulent, deceptive, or manipulative conduct, such as providing false or incomplete information to a counterparty to secure better terms or pricing or to alter the performance of ongoing rights and obligations, has the potential to harm counterparties to all forms of swap. As a result, the new rules would apply to all SBS transactions, not just credit default swaps.

Proposed Rules Regarding Chief Compliance Officers

In order to safeguard the independence of CCOs, the SEC is also proposing a new rule to make it unlawful for any officer, director, supervised person or employee of an SBS entity, or any person acting under such person's direction, to directly or indirectly take any action to coerce, manipulate, mislead or fraudulently influence the SBS entity's CCO in the performance of their duties under the federal securities laws. The SEC also proposes a new Rule 10B-1 which would enhance disclosure of SBS positions by requiring any person or group of persons with a SBS position that exceeds a specified reporting threshold to promptly file a Schedule 10B no later than the end of the first business day following the day of execution of the SBS transaction that results in the SBS position first exceeding the reporting threshold amount. The Schedule 10B would disclose the identity of the reporting person, the SBS position, the underlying loans or securities, and any other related loans and securities. In the event of any material change to a previously filed Schedule 10B, Rule 10B-1 would require the reporting person file an amendment.

The comment period will expire 45 days after publication of the proposed rules in the Federal Register.

Money Market Reforms

On December 15, 2021, the SEC proposed amendments to certain rules under the Investment Company Act of 1940, as amended (the "1940 Act") that govern money market funds. The proposed amendments are designed to improve the resilience and transparency of money market funds by (i) increasing minimum liquidity requirements, (ii) removing the ability of money market funds to impose liquidity fees and redemption gates when they fall below certain liquidity thresholds, which would eliminate an incentive for preemption redemptions, (iii) requiring the implementation of swing pricing so that redeeming investors bear the liquidity costs of their redemptions and (iv) enhancing certain reporting requirements to improve the SEC's ability to monitor and analyze money market fund data.

Amendments to Portfolio Liquidity Requirements

Currently, Rule 2a-7 of the 1940 Act requires that immediately after a money market fund acquires an asset, it must hold at least 10% of its total assets in daily liquid assets and at least 30% of its total assets in weekly liquid assets. This rule ensures that money market funds have sufficient liquidity to meet daily redemption requests, particularly in times of stress, when liquidity in the secondary market can be more difficult to access for many instruments in which they invest. After the market stress caused by the COVID-19 pandemic in March 2020, the SEC believes that an increased threshold will provide a more substantial buffer that would better equip money market funds to manage significant and rapid investor redemptions, like those experienced in March 2020, while maintaining funds' flexibility to invest in diverse assets during normal market conditions. As a result, the SEC proposes to increase the daily liquid asset requirement to 25% and the weekly liquid asset requirement to 50%.

Instead of performing the required 10% weekly liquid assets stress tests, each fund would be required to determine the minimum level of liquidity it seeks to maintain during stress periods, identify that liquidity level in its written stress testing procedures, periodically test its ability to maintain such liquidity, and provide the fund's board with a report on the results of the testing.

Moreover, the proposed rule would require a fund to notify its board of directors when the fund has invested less than 25% of its total assets in weekly liquid assets or less than 12.5% of its total assets in daily liquid assets (a "liquidity threshold event"). The proposal would require a fund to notify the board within one business day of the liquidity threshold event. The fund would be required to provide the board with a brief description of the facts and circumstances that led to the liquidity threshold event within four business days after its occurrence. The SEC believes that implementing such notification requirements would facilitate appropriate board notification, monitoring and engagement when a fund's liquidity levels decrease significantly below the minimum liquidity requirements.

Removing Liquidity Fee and Redemption Gate Provisions

Under current Rule 2a-7, a money market fund has the ability to impose liquidity fees or redemption gates after crossing a specified liquidity threshold. Specifically, a money market fund may impose a liquidity fee of up to 2%, or temporarily suspend redemptions for up to 10 business days, if the fund's weekly liquid assets fall below 30% of its total assets and the fund's board of directors determines that imposing a fee or gate is in the fund's best interests. Furthermore, a non-government money market fund is required to impose a liquidity fee of 1% on all redemptions if its weekly liquid assets fall below 10% of its total assets unless the board of directors of the fund determines that imposing such a fee would not be in the best interests of the fund. These provisions were initially implemented to serve as redemption restrictions that would provide a "cooling off" period to temper the effects of a short-term investor panic and preserve liquidity levels in times of market stress and to better allocate the costs of providing liquidity to redeeming investors. However, these provisions failed to achieve these objectives during the period of market stress in March 2020. During March 2020, even though no money market fund imposed a fee or gate, the possibility of the imposition of a fee or gate seemed to incentivize investors to redeem and for money market fund managers to maintain weekly liquid asset levels above the threshold, rather than use those assets to meet redemptions. Thus, these provisions appear to have potentially increased the risks of investor runs without providing benefits to money market funds as intended.

Accordingly, the SEC proposes to remove the ability of a money market fund to impose redemption gates under Rule 2a-7. Similarly, the SEC proposes to remove from Rule 2a-7 the provisions allowing or requiring money market funds to impose liquidity fees once the fund crosses certain liquidity thresholds. In proposing the removal of fees and gates from Rule 2a-7, the SEC notes that Rules 22e-3 and 22c-2 will continue to provide reasonable alternatives for the functions served by the fees and gates provisions of Rule 2a-7.

As for institutional prime and tax-exempt money market funds, the SEC expressed concern that the current rule would not protect remaining investors in a fund from dilution resulting from sizeable outflows in future periods of stress. The SEC believes it is important for these funds to have an effective tool to address shareholder dilution and potential institutional investor incentives to redeem quickly in times of liquidity stress to avoid further losses. As a result, the SEC proposes that institutional prime and tax-exempt money market funds be required to implement swing pricing, as discussed in more detail under the "Swing Pricing Requirement" section below.

Swing Pricing Requirement

As noted above, the SEC proposes to implement a swing pricing requirement specifically for institutional prime and institutional tax-exempt money market funds that would apply when the fund experiences net redemptions. Institutional prime and institutional tax-exempt money market funds would adopt policies and procedures to adjust a fund's current net asset value per share by a swing factor. The majority of the fund's independent directors would be tasked with approving these policies and procedures and would review them annually. A "swing pricing administrator" designated by the board, would be tasked with implementing the swing factor.

The SEC set forth guidelines as to how an institutional fund would determine its swing factor and explains that it depends on the amount of net redemption. If the fund has net redemptions that do not exceed the market impact threshold, the swing factor reflects the spread costs and transaction costs from selling a vertical slice of the portfolio to meet those net redemptions. If net redemptions exceed the market impact threshold, a fund's swing factor would also be required to include good faith estimates of the market impact of selling a vertical slice of a fund's portfolio to satisfy the amount of net redemptions for the pricing period.

In recognition of the difficulty of producing timely, good faith estimates of these costs, money market fund would be permitted to estimate costs and the market impact factor for each type of security with the same or substantially similar characteristics in the fund's portfolio and apply those estimates to all securities of that type, rather than analyze each security separately. The swing factor would be capped at a 2% upper limit to avoid the creation of a de facto gate.

The SEC believes that the swing pricing requirement would ensure that the costs stemming from net redemptions are fairly allocated and do not give rise to a first-mover advantage or dilution under either normal or stressed market conditions. The requirement would also address a fund's potential reluctance to impose a voluntary liquidity fee even when doing so might be beneficial to the fund.

Other Proposed Amendments

The proposal also provides that stable net asset value funds must convert to a floating share price if future market conditions result in negative fund yields. The SEC also proposes to amend certain reporting requirements on Forms N-MFP and N-CR to improve the availability of information about money market funds, as well as make certain conforming changes to Form N-1A to reflect the proposed changes to the regulatory framework.

The comment period will expire 60 days after publication of the proposed rules in the Federal Register.

Final Rules

Universal Proxy

On November 17, 2021, the SEC finalized amendments to the federal proxy rules to require the use of universal proxy cards by management and shareholders soliciting proxy votes for their own candidates in contested director elections.

The new rules seek to offer shareholders greater flexibility in electing directors from competing slates. Currently, shareholders voting by proxy in a contested election receive two separate proxy cards: one from the company, and one from the nominating shareholder. Shareholders are therefore forced to choose between the two slates, and are not able to elect a mix of the directors put forth by the company and dissident shareholder unless they attend the shareholder meeting and vote in person.

Under the new rules, nominating shareholders and companies will each have a single proxy card that includes all director nominees up for election and provides shareholders the ability to vote by proxy for their preferred set of director candidates in a "mix-and-match" fashion.

Dissident shareholders and the company will be required to provide shareholders with a proxy card that includes the names of both the company's nominees and the shareholder's nominees in any non-exempt proxy solicitation for contested director elections, except for solicitations at registered investment companies and business development companies. In addition to navigating the applicable notice requirements of a company's charter and bylaws, dissident shareholders will soon be required to provide notice to the company at least 60 days prior to the anniversary of the previous year's annual meeting of their director nominees. The company may provide such notice to a dissident shareholder following receipt of such notice, but no later than 50 days prior to the anniversary of the previous year's annual meeting of their director nominees to the company.

In addition, the final rules provide deadlines for nominating shareholders to file their proxy statement, require that nominating shareholders solicit holders of shares representing at least 67% of the voting power of the shares entitled to vote at the meeting and dictate certain formatting and presentation standards for the universal proxy cards.

The new rules generated a great deal of debate, particularly from activist shareholders who have argued that the new rules provide issuers with a greater strategic advantage over nominating shareholders. Several commenters asked the SEC staff to consider modifying the proposed rule to level the playing field between issuers and dissident shareholders, including by creating an exception from the 60-day nomination deadline for parties engaged in settlement negotiations and by modifying the "first look" at a dissident board slate that issuers are afforded under the new rules so that issuers would be required to announce their slate first. The SEC rejected these suggestions, arguing that existing market practices would remain largely unaffected by the new deadlines imposed.

The final rule amendments regarding universal proxy will apply to all shareholder meetings involving contested director elections held after August 31, 2022. The rule amendments regarding voting options will be applicable to all shareholder meetings involving director elections held after August 31, 2022.

Holding Foreign Companies Accountable Act Disclosure

On December 2, 2021, the SEC finalized its interim rules to implement the Holding Foreign Companies Accountable Act ("HFCAA"), which became effective January 1, 2021. The HFCAA was enacted in 2020 in response to growing concerns regarding a lack of oversight of the audits of Chinese firms listed on stock exchanges in the United States. The accounting fraud scandal at Luckin Coffee and the refusal by China to allow the Public Company Accounting Oversight Board ("PCAOB") to oversee the audits of Chinese public companies increased pressure on U.S. regulators to enact rules protecting investors from potential fraud. The final rules implementing the HFCAA impose submission and disclosure requirements as well as trading prohibitions for certain issuers identified as Commission-Identified Issuers in order to address these concerns.

Commission-Identified Issuer

A "Commission-Identified Issuer" is an issuer identified by the SEC as having filed an annual report containing an audit report issued by a registered public accounting firm located in a foreign jurisdiction that the PCAOB has determined is unable to fully inspect or investigate because of a position taken by an authority in such foreign jurisdiction. The SEC will promptly identify such Commission-Identified Issuers after the filing of their annual report and then provisionally identify such issuer as a Commission-Identified Issuer on the SEC's website. If an issuer does not contact the SEC to dispute the provisional identification within 15 business days, the SEC will conclusively identify the issuer as a Commission-Identified Issuer.

Submission and Disclosure Requirements

The final rules require Commission-Identified Issuers that are not owned or controlled by a governmental entity in the foreign jurisdiction of its registered public accounting firm to submit documentation to the SEC on or before its annual report due date stating that it is not owned or controlled by a governmental entity in its public accounting firm's foreign jurisdiction. The HFCAA has not defined the term "owned or controlled," however, the SEC interprets this term to have the same meaning as the term "control" under the 1934 Act and the 1934 Act rules. A Commission-Identified Issuer that is owned or controlled by a foreign governmental entity is not required to submit such documentation.

If a Commission-Identified Issuer is also a foreign issuer, as defined in Exchange Act Rule 3b-4, such Commission-Identified Issuer will also be required to provide certain additional disclosures in its annual report for itself and its consolidated foreign operating entity or entities, including any variable-interest entity or similar structure that results in additional foreign entities being consolidated in the registrant's financial statements, including any variable-interest entity or similar structure that results in additional foreign entities being consolidated in the issuer's financial statements.

The additional disclosures include (i) identifying the registered public accounting firm that has caused the issuer to be identified as a Commission-Identified Issuer during the period covered by the form, (ii) the percentage of the issuer's shares owned by governmental entities in the foreign jurisdiction in which the issuer is incorporated or otherwise organized, (iii) whether governmental entities in the foreign jurisdiction where the registered public accounting firm is located have a controlling financial interest in the issuer, (iv) the name of each official of the Chinese Communist Party who is a member of the board of directors of the issuer (if any) or the operating entity with respect to the issuer and (v) whether the articles of incorporation of the issuer (or equivalent organizing document) contains any charter of the Chinese Communist Party, including the text of any such charter.

Trading Prohibitions

The HFCAA requires the SEC to prohibit the trading of securities of certain Commission-Identified Issuers on a national securities exchange or through any other method that is within the SEC's jurisdiction to regulate, including through over-the-counter trading. Pursuant to this requirement, the SEC will impose an initial trading prohibition on an issuer as soon as practicable after it is conclusively identified as a Commission-Identified Issuer for three consecutive years. If the SEC ends the initial trading prohibition and, thereafter, the issuer is again determined to be a Commission-Identified Issuer, the SEC will impose a subsequent trading prohibition on the issuer for a minimum of five years. To end an initial or subsequent trading prohibition, a Commission-Identified Issuer must certify that it has retained or will retain a registered public accounting firm that the PCAOB has determined it is able to inspect or investigate.

The SEC will identify issuers pursuant to the HFCAA based on the PCAOB's determination and a registrant's annual report for fiscal years beginning after December 18, 2020.

Southern District of New York Grants SEC Emergency Asset Freeze for Twitter "Scalping"

On October 26, 2021, the SEC filed a complaint and emergency motion for a temporary restraining order against Steven M. Gallagher, also known as his Twitter handle "AlexDelarge6553." The Court granted the motion the same day. The SEC alleges violations of Section 17(a) of the Securities Act of 1933, Section 9(a)(2) and Section 10(b) of the Securities Exchange Act of 1934, and Rule 10b-5. The purpose of the asset freeze was to preserve Gallagher's assets—up to $6.9 million—that may be used to satisfy any civil money penalty imposed against him, including for disgorgement of ill-gotten gains and pre-judgment interest.

In its complaint, the SEC alleges Gallagher has engaged in "scalping" on Twitter. Scalping occurs when a person: (1) acquires shares of a stock; (2) recommends that others purchase the stock without disclosing their intention to sell; and (3) later sells their stock for their own benefit. The SEC alleges that since at least December 2019 and through October 2021, Gallagher sent direct messages and thousands of tweets to his over 70,000 followers encouraging them to buy stocks in companies in which he already had a large holding. The SEC alleges Gallagher engaged in scalping for at least 60 issuers and amassed approximately $3.39 million in profit.

The complaint details Gallagher's process of direct messaging with a select group of Twitter users to buy stock before sending out an "alert" tweet to his followers encouraging them to buy in the same company. These "alerts" contain false and/or misleading information. For example, in a December 2020 alert tweet, Gallagher excerpted portions of the target company's November 2017 quarterly report stating the company was meeting with the Food and Drug Administration. However, the target company had not filed any quarterly reports after November 2017 and Gallagher's representation misleadingly suggested it was happening in the present. Once Gallagher sent the alert tweet, he followed up with tweets stating his confidence in the stock and his intention to hold his position. The complaint contains quotes from tweets responding to Gallagher indicating his followers were in fact following his advice and buying stock in the target. The SEC detailed the timing of Gallagher's tweets and his trading orders, designed to maintain the appearance of an active market, while in reality Gallagher was selling millions of shares at a profit.

The SEC's press release announcing the injunction included a warning against making investment decisions based on social medial and "aggressive stock promotion."

SEC v. Steven M. Gallagher, Civ. No. 1:21-cv-08739 (S.D.N.Y. Oct. 26, 2021) available at: https://www.sec.gov/litigation/complaints/2021/comp-pr2021-214.pdf.

Fraud Case in Southern District of New York Settles for $125M

On December 21, 2021, the SEC announced it reached an agreement with Nikola Corporation to settle the fraud claims the SEC brought against the company in July 2021. Nikola was founded in 2015 by Trevor R. Milton (also the former CEO and former executive chairman) to manufacture alternative fuel trucks and built alternative fuel station infrastructure. Around that time, Milton helped raise over $1 billion in private offerings and Nikola went public through a special purpose acquisition company and traded on the Nasdaq.

In July 2021, the SEC filed its complaint against Milton for making false and misleading statements to investors, made primarily by speaking to investors through social media. The SEC alleges violations of Section 17(a) of the Securities Act of 1933 and Section 10(b) of the Securities Exchange Act of 1934, and Rule 10b-5. Examples of Milton's false and misleading statements include: claiming Nikola's first semi-truck prototype could be driven under its own power, that Nikola was producing hydrogen at close to four times less than the prevailing market rates, that Nikola had "billions and billions" of dollars of truck orders, and that Nikola had developed a "game-changing" battery technology. Each of these statements were either false (e.g., Nikola was not producing any hydrogen) or misleading (e.g., the semi-truck was rolling down an incline, not moving under its own power).

In addition to Twitter, Milton made television and podcast appearances during which he made public statements and held himself out as a technology expert. Milton's online misrepresentations began as early as January 2018 and picked up from November 2019 to April 2020, culminating with a "media blitz" from June to September 2020. The media blitz overlapped with Nikola filing a registration statement on Form S-1 with the SEC in June 2020. Milton's tweets and public appearances were not adequate disclosures and often other Nikola executives learned information for the first time, in real time, as Milton made the announcements. In its December 21, 2021 order, the SEC stated, "Nikola did not design, implement, or maintain adequate disclosure controls or procedures to assess whether the information Milton published via social media and television and podcast appearances was required to be disclosed in Nikola's Exchange Act reports with the time periods specified in the Commission's rules and forms." (Order at ¶ 19).

For its violations, Nikola will pay a civil monetary penalty in the amount of $125 million.

SEC v. Trevor R. Milton, Civ. No. 1:21-cv-06445 (S.D.N.Y. June 29, 2021), Complaint available at: https://www.sec.gov/litigation/complaints/2021/comp-pr2021-141.pdf; *In re Nikola Corporation*, A.P. File No. 3-20687, SEC Order available at: https://www.sec.gov/litigation/admin/2021/33-11018.pdf.