SMU Annual Texas Survey

Volume 7 Article 11

2021

Securities Regulation

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The authors wish to thank Holland & Knight attorneys Jenna Johnson and Christian Rice for their significant contributions to the writing of this article.

I. INTRODUCTION

Securities regulation laws aim primarily to protect investors from fraud in connection with the sale of securities. Texas's main statute for combatting this type of fraud is the Texas Securities Act (TSA).[1] The Texas State Securities Board (TSSB) is the regulatory body charged with the statute's enforcement,[2] but aggrieved plaintiffs may also bring private causes of action for TSA violations.[3] At the federal level, the Securities and Exchange Commission (SEC) creates rules and regulations regarding the securities markets and has the power to bring civil enforcement actions.[4] Certain provisions of the federal securities laws, including the Securities Act of 1933 and the Securities Exchange Act of 1934 (the Exchange Act) also give rise to private actions, which are commonly brought as class action lawsuits.[5]

The year, 2020 was a relatively sluggish year for private securities litigation and class actions. Indeed, securities class actions decreased significantly from the prior year in the first half of 2020—attributable to the COVID-19 pandemic court closures and a decreased number of mergers at the onset of the pandemic.[6] Despite the pandemic, the SEC brought 715 enforcement actions, down surprisingly only 17% from the prior year.[7] The SEC also saw record-breaking monetary recoveries including $3.589 billion in disgorgement,[8] $1.091 billion in civil penalties,[9] and, separately, $175 million paid to whistleblowers who reported violations to the agency.[10] The steady flow of enforcement actions is likely also a result of the myriad opportunities for fraud and misleading disclosures occasioned by the pandemic and the many market disruptions and opportunities it created.

This Article updates the Texas-based securities practitioner on notable developments in securities regulation, primarily within the period of December 1, 2019, to November 30, 2020. Part II analyzes Texas and federal enforcement actions and trends. This will be followed by a review and evaluation of the Texas Securities Act and federal securities law cases, including common pleading pitfalls demonstrated by investors in bringing securities fraud claims, in Part III. Part IV will examine a critical Supreme Court case involving disgorgement as an equitable remedy and

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1. *See* Tex. Rev. Civ. Stat. Ann. arts. 581-1–581-45.
2. *See Texas State Securites Board*, Tex. State Sec. Bd., https://www.ssb.texas.gov/#:~:text=the%20mission%20of%20the%20State,of%20new%20jobs%20in%20Texas [https://perma.cc/VF5P-BCZ2].
3. *See* Tex. Rev. Civ. Stat. art. 581-33.
4. *See* 15 U.S.C. §§ 77k(a), 77l(a)(2), 78(j).
5. *See* Brian Elzweig, *Unintended Consequences, Loopholes, and Gibberish: Why There Are Still Securities Act Class Actions in State Courts*, 7 Tex. A&M L. Rev. 153, 156–58 (2019).
6. James R. Carroll, Jay B. Kasner, Scott D. Musoff, Alisha Q. Nanda & Noelle M. Reed, *Developments and Trends in Securities Litigation: Mid-Year Update 2020*, Skadden, Arps, Slate, Meagher & Flom LLP (Oct. 28, 2020), https://www.skadden.com/insights/publications/2020/10/key-takeaways-developments-and-trends [https://perma.cc/8QRC-5HPM].
7. Div. of Enf't, U.S. Sec. & Exch. Comm'n Ann. Rep. 16 (2020), https://www.sec.gov/files/enforcement-annual-report-2020.pdf [https://perma.cc/ZR4Q-USKT].
8. *Id.* at 17.
9. *Id.*
10. *Id.* at 5.

subsequent legislation effective January 1, 2021. In addition, Part IV addresses developments on the continuing constitutionality of bringing securities claims before administrative law judges. Part V reviews new and proposed rulemakings, SEC priorities and policy shifts under the Biden administration, and makes predictions for the year ahead.

II. ENFORCEMENT UPDATES

A. Texas Enforcement Actions

In Texas, the TSSB administers and enforces the provisions of the TSA.[11] The TSSB often enforces the TSA by issuing emergency cease and desist orders. These enforcement actions commonly center on fraud in foreign exchange markets and cryptocurrency-related investment schemes,[12] as well as in oil and gas investments, all of which proved to be a continuing focus over the past year.[13]

The TSSB focuses on oil and gas investments because of the complexity of the subject matter to lay investors and the highly speculative nature of the investment.[14] As in prior years, the TSSB obtained successful cease and desist orders against oil and gas drilling programs soliciting potential investors. For example, the TSSB obtained a cease and desist order against a promoter who solicited drilling program investments online and on LinkedIn. The promoter touted the investment's profitability despite the decline in the price of oil to $20.00 per barrel and had failed to pay obligations to prior investors.[15]

The TSSB shut down another promoter who advertised its investment as "mailbox money," promising: (1) a well would initially produce 2,000 barrels of oil per day and recover up to two million barrels total; (2) returns between 54% and 221% of the principal investment; and (3) the investment would still return between 22% and 74% profits even with the decrease in oil prices.[16]

In another successful cease and desist action, an independent oil and gas company made misleading statements in advertising its investments in the working interest of a well in Michigan as "annuity-like" investments.[17] The TSSB found such a comparison was fraudulent and mislead-

11. *See* Tex. Rev. Civ. Stat. Ann. art. 581-2; *About Us*, Tex. State Sec. Bd., https://www.ssb.texas.gov/about-us [https://perma.cc/3KLG-W8YY].

12. *See The Investor's Guide to Cryptocurrency Offerings*, Tex. State Sec. Bd., https://www.ssb.texas.gov/investors-guide-cryptocurrency-offerings [https://perma.cc/L5EW-X4VL].

13. *See infra* notes 14–20.

14. *See Top 10 Investor Threats (In Time for the Holidays)*, Tex. State Sec. Bd. (Nov. 29, 2017), https://www.ssb.texas.gov/news-publications/top-10-investor-threats-time-holidays [https://perma.cc/9SRE-BRV5].

15. Tex. State Sec. Bd., *In re* Tex. Shallow Oil & Gas, Order No. ENF-20-CDO-1802, 2020 WL 2029877, at *1 (Apr. 16, 2020) (emergency cease and desist order).

16. Tex. State Sec. Bd., *In re* PRT Consulting, Order No. ENF-20-CDO-1810, 2020 WL 3412283, at *5 (June 17, 2020) (emergency cease and desist order).

17. Tex. State Sec. Bd., *In re* Energy Investment Partners, Order No. ENF-20-CDO-1818, 2020 WL 5353333, at *2–3 (Sept. 1, 2020) (emergency cease and desist order).

ing.[18] Unlike annuities, which provide regular disbursements for long-term investments and are designed to protected purchasers (often retirees from outliving income), unregistered working interests in oil and gas wells are volatile and often risky investments.[19] Additionally, the description of "annuity-like" was also misleading because Texas insurance laws applicable to annuities that protect consumers do not apply to working interests in oil wells.[20]

The TSSB also issued a number of successful cease and desist orders against individuals alleged to have violated the TSA through cryptocurrency scams. For example, an entity and individuals in Spain who sought new investors targeted Texas residents for their "crypto-fiat arbitrage trading program," flaunting returns of 16% per month by using artificial intelligence, "advanced algorithms," and "bots" to find optimum moments for trading in foreign currency exchange and cryptocurrency markets.[21] They also encouraged their investors to use bitcoin to purchase their own "internal use utility token," the "MCcoin."[22] Another cryptocurrency scheme involved soliciting investment plans through the internet and promising the investment's profitability (and up to 600% returns), regardless of the changes in the value of bitcoin, a notoriously volatile cryptocurrency.[23] Still another crypto-scam involved an entity and an account manager selling investment plans to investors based upon their claimed ability to both trade and "mine" cryptocurrency.[24] They also assured profitability despite bitcoin price changes, and falsely represented their registration with the Commodity Futures Trading Commission (CFTC).[25]

Not surprisingly, cryptocurrency and foreign exchange fraud overlapped with pandemic-related fraud in 2020. In 2020, the TSSB pursued scammers attempting to exploit the COVID-19 pandemic, capitalizing off market volatility and failing to make disclosures about the associated risks to potential investors. For example, the TSSB issued a cease and desist order in one enforcement action against an unregistered dealer who solicited investments in foreign exchange and binary options trading by telling investors that the "stock market is crumbling," and "inviting them to 'profit off the coronavirus' " pandemic, all while misappropriating invested funds.[26] The TSSB also brought a successful cease and desist action against an unregistered dealer soliciting investments in cryptocur-

18. *Id.*
19. *Id.*
20. *Id.*
21. Tex. State Sec. Bd., *In re* Mind Capital, Order No. ENF-20-CDO-1814, 2020 WL 4281050, at *2 (July 16, 2020) (emergency cease and desist order).
22. *Id.*
23. Tex. State Sec. Bd., *In re* LoudMines, Order No. ENF-20-CDO-1812, 2020 WL 3960489, at *1–2 (July 8, 2020) (emergency cease and desist order).
24. Tex. State Sec. Bd., *In re* Swiftminex, Order No. ENF-20-CDO-1813, 2020 WL 3960490, at *1–3 (July 8, 2020) (emergency cease and desist order).
25. *Id.*
26. Tex. State Sec. Bd., *In re* Kenzley Ramos, Order No. ENF-20-CDO-1803, 2020 WL 2029878, at *1 (Apr. 17, 2020) (emergency cease and desist order).

rency through a Facebook group and Craigslist, and making materially misleading statements to investors that COVID-19 "helped [him] tremendously" in returning "huge profits" from bitcoin trades without disclosing the risk inherent in cryptocurrency markets.[27] Similarly, in another action, the TSSB ordered an unregistered dealer and its agent to cease and desist from selling securities when they were advising potential investors to "tak[e] advantage of changes in the markets due to COVID-19" by using their 401k funds to purchase forex accounts managed by respondents.[28] In another action, the TSSB ordered a promoter to cease and desist from selling securities in a "Master Account Client Trading Program" that he characterized as a "recession-proof" investment that could provide "supplemental income" to families and retirees enduring economic hardships during the recessionary markets of COVID-19.[29]

B. Federal Enforcement Updates Review

1. SEC Enforcement Trends

The SEC has also brought various enforcement actions pertaining to COVID-19-related fraud. Similarly, the SEC issued a number of trading suspensions against companies making claims about COVID diagnostics, treatments, and business models, and against companies who were untimely in filing required periodic or annual reporting with the SEC.[30]

Among the first of the enforcement actions was a charge against a Florida company and its CEO for allegedly making false and misleading statements about its ability to source and guarantee supply of hefty quantities of N95 and other masks.[31] In May, the SEC successfully shut down two more companies' fraudulent activities: one for purporting to sell "finger-prick COVID-19 tests" that were not approved by the U.S. Food and Drug Administration, and another for representing that its thermal scanning equipment to detect fevers was "99.99%" accurate and "designed to be deployed IMMEDIATELY in each State"—despite lacking any contracts to sell or partnerships in place to do so.[32] In yet another case, the SEC charged and suspended trading of a California company for allegedly engaging in a "pump and dump" scheme which involved making hundreds of allegedly false and misleading statements online, including

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27. Tex. State Sec. Bd., *In re* Nickolas Steele, Order No. ENF-20-CDO-1804, 2020 WL 2615704, at *1, *5 (May 15, 2020) (emergency cease and desist order).

28. Tex. State Sec. Bd., *In re* KP Financials, LLC, Order No. ENF-20-CDO-1827, 2020 WL 7024148, at *3 (Nov. 19, 2020) (emergency cease and desist order).

29. Tex. State Sec. Bd., *In re* James Frederick Walsh, Order No. ENF-20-CDO-1800, 2020 WL 1844129, at *2 (Apr. 3. 2020) (emergency cease and desist order).

30. *SEC Coronavirus (COVID-19) Response*, U.S. Sec. & Exch. Comm'n, https://www.sec.gov/sec-coronavirus-covid-19-response [https://perma.cc/Z4YQ-RFBX].

31. Press Release, U.S. Sec. & Exch. Comm'n, 2020-97, SEC Charges Company and CEO for COVID-19 Scam (Apr. 28, 2020), https://www.sec.gov/news/press-release/2020-97 [https://perma.cc/5YHQ-N5GQ].

32. Press Release, U.S. Sec. & Exch. Comm'n, 2020-111, SEC Charges Companies and CEO for Misleading COVID-19 Claims (May 14, 2020), https://www.sec.gov/news/press-release/2020-111 [https://perma.cc/C2D8-VQPC].

statements related to its development of an "approved" COVID-19 blood test.[33] The SEC also charged six off-shore entities and five individuals for allegedly engaging in a fraudulent scheme by selling illegal company stock while concealing the identities of persons who controlled the company.[34] Additionally, the SEC charged these persons for making misleading representations to dupe investors by representing their ability to produce medical-quality face masks.[35] In another action, the SEC charged a corporation's president for allegedly representing his company's development of a COVID-19 blood test and advertising "high demand" for the test, despite not yet having purchased the materials to create the test.[36] Besides enforcement actions, numerous companies received temporary trading suspensions due to offering COVID-19 related medical supplies and claimed treatments,[37] a trend expected to continue.

COVID-19-related fraud enforcement also extended to companies who failed to make accurate disclosures about their financial position because of the pandemic. The SEC issued guidance in April that companies should provide "as much information as is practicable regarding their current financial and operating status," and their financial planning for the future with regard to their disclosures.[38] And the SEC was not hesitant to enforce that guidance, capping off the year by settling with restaurant The Cheesecake Factory for making false representations in its March and April 2020 SEC filings.[39] The SEC stated The Cheesecake Factory falsely represented it was "operating sustainably," despite losing $6 million a week and having only enough cash left to operate for sixteen

33. Press Release, U.S. Sec. & Exch. Comm'n, 2020-128, SEC Charges California Trader Engaged in Manipulative Trading Scheme Involving COVID-19 Claims (June 9, 2020), https://www.sec.gov/news/press-release/2020-128 [https://perma.cc/DG58-8EJ5].

34. Press Release, U.S. Sec. & Exch. Comm'n, 2020-131, SEC Charges Microcap Fraud Scheme Participants Attempting to Capitalize on the COVID-19 Pandemic (June 11, 2020), https://www.sec.gov/news/press-release/2020-131 [https://perma.cc/W6A3-XWCB].

35. *Id.*

36. Press Release, U.S. Sec. & Exch. Comm'n, 2020-224, SEC Charges Top Executive of California Microcap Company for Misleading Claims Concerning COVID-19 Test and Financial Statements (Sept. 25, 2020), https://www.sec.gov/news/press-release/2020-224 [https://perma.cc/W28P-WABU].

37. *See, e.g.*, No Borders, Inc., Exchange Act Release No. 88549, 2020 WL 1686461 (Apr. 3, 2020), https://www.sec.gov/litigation/suspensions/2020/34-88549.pdf [https://perma.cc/VA2B-9DR2] (COVID-19 test kits and distributions of PPE); Predictive Technology, Inc., Exchange Act Release No. 88719, 2020 WL 1940991 (Apr. 21, 2020), https://www.sec.gov/litigation/suspensions/2020/34-88719.pdf [https://perma.cc/AX4E-9DVK] (serology tests to detect antibodies); EastWest Bioscience Inc., Exchange Act Release No. 89265, 2020 WL 3883272 (July 8, 2020), https://www.sec.gov/litigation/suspensions/2020/34-89265.pdf [https://perma.cc/SXA9-4ELW] (statements that FDA approved issuer's hand sanitizer).

38. Jay Clayton & William Hinman, *The Importance of Disclosure–For Investors, Markets and Our Fight Against COVID-19*, U.S. SEC. & EXCH. COMM'N (Apr. 8, 2020), https://www.sec.gov/news/public-statement/statement-clayton-hinman [https://perma.cc/2X9V-HEM7].

39. Press Release, U.S. Sec. & Exch. Comm'n, 2020-306, SEC Charges The Cheesecake Factory for Misleading COVID-19 Disclosures (Dec. 4, 2020), https://www.sec.gov/news/press-release/2020-306 [https://perma.cc/6DL6-4SAR].

weeks.[40] Ultimately the restaurant agreed to cease and desist and paid a $125,000.00 penalty.[41] Some companies had trading suspended for failure to file timely disclosures in general. For example, the SEC temporarily suspended "Zoom Technologies" out of concerns for adequacy of its public filings (or lack thereof—because it had filed no public disclosures since 2015), and out of concerns for confusing the issuer with the similarly-named NASDAQ issuer, Zoom Video Communications.[42]

2. *DOJ Enforcement Trends*

The Department of Justice (DOJ) investigates criminal fraud through its Foreign Corrupt Practices Act (FCPA), Health Care Fraud (HCF), and Market Integrity and Major Frauds (MIMF) Units. Securities fraud prominently overlaps with two of its three major fraud units—HCF and MIMF. Across all three fraud units, the DOJ charged 326 individuals in 2020.[43] More than half of those prosecutions were related to Health Care Fraud for an alleged $3.77 billion in fraud-related losses.[44] As part of the HCF Unit's COVID-19 fraud initiative, the DOJ worked closely with federal law enforcement and public health officials to combat emerging trends related to healthcare fraud.[45] Specifically, the HCF Unit tackled issues such as "COVID-19 test bundling schemes, securities fraud cases involving healthcare technology companies, and Health Resources and Services Administration (HRSA) fraud cases."[46] The DOJ brought its very first COVID-19-related action in March 2020 in Austin against operators engaging in a wire fraud scheme by selling coronavirus vaccine kits (when no approved vaccines existed at that time).[47] HCF Unit expects prosecutions related to both COVID-19 and securities fraud schemes to continue in the future.[48]

Almost half of the other total prosecutions this year comprised MIMF actions.[49] MIMF investigates financial fraud schemes and prosecutes complex schemes dealing with binary options, cryptocurrency, pyramid-schemes, and Ponzi-schemes.[50] Recently, its efforts have included prosecuting fraudulent schemes related to Paycheck Protection Program (PPP) loans and securities schemes attempting to exploit the COVID-19 pan-

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40. *Id.*
41. *Id.*
42. Zoom Technologies, Inc., Exchange Act Release No. 88477, 2020 WL 1610845 (Mar. 25, 2020), https://www.sec.gov/litigation/suspensions/2020/34-88477.pdf [https://perma.cc/5Y2W-GHH3].
43. U.S. DEP'T OF JUST., FRAUD SECTION YEAR IN REVIEW 5 (2020), https://www.justice.gov/criminal-fraud/file/1370171/download [https://perma.cc/93FA-KVNR].
44. *Id.*
45. *Id.* at 25.
46. *Id.*
47. *Justice Department Files Its First Enforcement Action Against COVID-19 Fraud*, U.S. DEP'T OF JUST. (Mar. 22, 2020), https://www.justice.gov/opa/pr/justice-department-files-its-first-enforcement-action-against-covid-19-fraud [https://perma.cc/VPR3-XZDW].
48. U.S. DEP'T OF JUST., *supra* note 43, at 25.
49. *Id.* at 5.
50. *Id.* at 34.

demic.[51] In 2020, MIMF charged ninety-seven defendants across sixty-seven cases involving PPP-fraud, amounting to an alleged $260 million in losses.[52] In addition, the MIMF Unit has also focused on cases involving public companies misleading investors in connection with the pandemic.[53]

3. *Parallel DOJ and SEC Enforcement Actions*

In some cases, the SEC and DOJ work in tandem to investigate and prosecute securities fraud. This year had a handful of such parallel actions of note. In one action, the SEC found Wells Fargo "misled investors about the success of its core business strategy" while it opened unauthorized accounts for its customers.[54] Ultimately, Wells Fargo was ordered to pay the SEC a $500 million civil penalty as part of a $3 billion settlement with the SEC and DOJ.[55] In another settled action in which the DOJ and the CFTC also brought parallel matters, the SEC found that JP Morgan "fraudulently engaged in manipulative trading of U.S. Treasury securities."[56] After admitting to the SEC's findings, J.P. Morgan paid $10 million in disgorgement and a civil penalty of $25 million as part of the settlement.[57]

III. TEXAS AND FEDERAL SECURITIES FRAUD CASES

Although courts across the country saw a slowdown in securities litigation during the first half of the year due to court closures, both Texas state and federal courts issued a number of decisions regarding the TSA, federal securities acts, or cases implicating other areas of fraud. Because the TSA's language was modeled off the federal acts and they are interpreted similarly,[58] this Part will explore both Texas cases and federal securities cases from within the Fifth Circuit.

A. Texas Courts Continue to Decline to Recognize Common Law Cause of Action for Aiding and Abetting Fraud

The Third Austin Court of Appeals this year declined to create a new cause of action for aiding and abetting fraud.[59] *Hampton v. Equity Trust Co.* involved an investor who sued Equity Trust Company for "aiding and abetting" violations of the TSA and common law fraud, alleging that they had participated with the co-defendant who defrauded investors by sell-

51. *Id.* at 32.
52. *Id.* at 33.
53. *Securities Fraud*, U.S. Dep't of Just., https://www.justice.gov/criminal-fraud/securities-fraud [https://perma.cc/7AXJ-VE6X].
54. U.S. Sec. & Exch. Comm'n, *supra* note 7, at 3.
55. *Id.*
56. *Id.* at 4.
57. *Id.*
58. George Lee Flint, Jr., *Securities Regulation*, 6 SMU Ann. Tex. Surv. 363, 376 (2020); *see* Highland Cap. Mgmt., LP, v. Ryder Scott Co., 402 S.W.3d 719, 741 (Tex. App.—Houston [1st Dist.] 2012, no pet.).
59. Hampton v. Equity Tr. Co., 607 S.W.3d 1, 5 (Tex. App.—Austin 2020, pet. filed).

ing participation shares in promissory notes that turned out to be worthless.[60] The court below rendered judgment for the plaintiff on her common law fraud claim, but set aside the jury's verdict for the TSA claim.[61]

On appeal, the plaintiff argued that civil liability for aiding and abetting fraud existed in Texas—and if it did not, urged the court to adopt Section 876 of the Restatement of Torts.[62] The court noted that the Texas Supreme Court had left open the question of whether the theory of liability in § 876 is recognized in Texas.[63] In the absence of Texas Supreme Court or legislative recognition, the court declined to recognize a common law cause of action for aiding and abetting.[64] Accordingly, the court reversed the judgment on the common law fraud claim.[65]

B. The Texas Anti-SLAPP as Applied to Fraud Under the TSA

Defendants charged with TSA claims have attempted to have charges dismissed, arguing that their allegedly fraudulent statements were protected by free speech and freedom of association rights. In *Anders v. Oates*, the Second Fort Worth Court of Appeals considered whether the Texas Citizens Participation Act (TCPA) applied to claims against an agent of the purchasers for violations of the Texas Securities Act.[66] The sellers alleged that they signed an Interest Purchase Agreement selling 100% of their ownership interest in two companies—for which purchasers had failed to pay both the purchase price and the debts.[67] The agent of the purchasers argued in his TCPA motion to dismiss that the sellers sought to impose liability based on his "exercise of the right of association" with the group that acquired the companies.[68] He further argued that to the extent the court construed the claims against him as alleging misrepresentations of the purchase price, the TCPA would apply to bar the claims because they would be based on a communication made in connection with "economic concerns," thereby implicating the freedom of speech.[69] The court rejected both arguments, holding that the TCPA's protection for freedom of association's "common interest" "requires more than two tortfeasors conspiring to act tortiously for their own selfish benefit."[70] Likewise, the TCPA did not apply to statements about the

60. *Id.* at 3.
61. *Id.*
62. *Id.*
63. *Id.* at 4 (citing First United Pentecostal Church of Beaumont v. Parker, 514 S.W.3d 214, 224 (Tex. 2017)).
64. *Id.* at 5.
65. *Id.* at 8–9.
66. Anders v. Oates, No. 02-19-00116-CV, 2020 WL 1809654, at *6 (Tex. App.—Fort Worth Apr. 9, 2020, no pet.) (mem. op.).
67. *Id.* at *1–2.
68. *Id.* at *2.
69. *Id.*
70. *Id.* at *5 (citing Kawcak v. Antero Res. Corp., 582 S.W.3d 566, 588 (Tex. App.—Fort Worth 2019, pet. denied)).

purchase price because the alleged communications were related only to the "pecuniary interests of the defendants," rather than protected statements "related to matters of political, social, or other concern to the community."[71]

C. Investor Pleading Deficiencies

Investors bringing fraud claims under the federal acts must plead six elements: (1) a material misrepresentation (or omission); (2) scienter; (3) a connection with the purchase or sale of a security; (4) reliance; (5) economic loss; and (6) loss causation.[72] Additionally, the Private Securities Litigation Reform Act (PSLRA) creates a heightened pleading standard that requires plaintiffs to "specify each statement alleged to have been misleading, the reason or reasons why the statement is misleading, and, if an allegation regarding the statement or omission is made on information and belief, the complaint shall state with particularity all facts on which that belief is formed."[73] Regarding scienter, a federal claim requires the plaintiff to allege facts demonstrating a "strong inference" that the defendant had the requisite state of mind.[74] TSA violations largely mirror the federal elements, but do not require pleading the element of scienter.[75] These elements of "material omissions" for federal and TSA claims and "strong inference" of scienter for federal claims are frequently inadequately pled by plaintiffs, subjecting their securities claims to 12(b)(6) dismissal. The following cases will examine case law discussing these and other common investor pleading deficiencies.

1. *Preliminary Issues: Failing to Adequately Brief Whether Investments Were "Securities," Failure to Adequately Allege Personal Jurisdiction*

In *Crain v. E&M Operating*, the court denied default judgment for alleged violations of the Securities Act of 1933, the Exchange Act, and the Texas Securities Act because plaintiffs did not adequately brief whether the promissory notes at issue were "securities" under the relevant laws.[76] Plaintiffs alleged that defendants' sale of promissory notes and promise to provide the notes, together with a signed subscription agreement and private placement memo regarding the oil and gas investments showed that the transactions at issue were "investment contracts," and thus were

71. *Id.* at *7.
72. Dura Pharms., Inc. v. Broudo, 544 U.S. 336, 341–42 (2005); 15 U.S.C. § 78(u)–4(b).
73. 15 U.S.C. § 78(u)–4(b)(1).
74. *Id.* § 78(u)–4(b)(2).
75. Dorsey v. Portfolio Equities, Inc., 540 F.3d 333, 343–44 (5th Cir. 2008) ("an article 581-33 claim does not require scienter[.]"). Instead, plaintiffs need only prove that a security was sold by means of (1) an untrue statement of material fact, or (2) an omission of a material fact necessary to make the statement not misleading. Tex. Rev. Civ. Stat. Ann. art. 581-33(A)(2).
76. Crain v. E&M Operating, L.L.C., No. 18-CV-00548, 2019 WL 6770732, at *5 (W.D. La. Dec. 11, 2019).

properly considered "securities."[77] However, the court denied the claims because plaintiffs failed to provide evidence or authority showing an investment contract existed under similar circumstances.[78]

In *Kliebert v. Metallicus*, plaintiffs failed to allege facts sufficient to confer personal jurisdiction over the defendants, who plaintiffs alleged violated the TSA.[79] As the basis of personal jurisdiction, the plaintiffs alleged that they attended a presentation by defendants (outside of Texas) and subsequently made investments while they were in Texas based on those marketing efforts.[80] The court found that this was insufficient to establish that defendants had minimum contacts with the state.[81] No facts showed defendants targeted their marketing efforts to Texas residents, and jurisdiction could not rest on "mere fortuity" that plaintiffs themselves were Texas residents and defendants allegedly committed business torts against them.[82]

2. *Failing to Adequately Plead Misstatements and Omissions*

a. *Heinze v. Tesco Corp.*—Failure to Plead Misstatements or Omissions, or Plead Around PSLRA Safe Harbor

In *Heinze*, the Fifth Circuit Court of Appeals held that a lead plaintiff shareholder failed to allege a plausible claim under the Exchange Act and SEC Rule 14a-9 through allegations that defendant's proxy statement contained materially misleading statements.[83] Specifically, the shareholder argued that three parts of the proxy statement were misleading: (1) the statement that Tesco shareholders would receive a "significant" 19% premium over closing price on the last day of trading as a result of a proposed acquisition; (2) a table containing projections for revenue and Earnings Before Interest, Taxes, Depreciation, and Amortization (EBITDA) in 2017 and 2018; and (3) the summary of the fairness opinion of the defendant's bank.[84] With regard to the first statement, the court found that a reasonable shareholder would have relied on the *quantity* of the premium (19%), and not the adjective "significant" in reviewing the proxy, and as such, the statement was not materially misleading.[85]

As to the EBIDTA projections, the court found that the plaintiff's vague allegations that the projections did not demonstrate the full extent of Tesco's "growth potential" based on projections of oil prices increasing was insufficient to allege a claim based on material omissions.[86] Addition-

77. *Id.* at *4.
78. *Id.* at *5.
79. Kliebert v. Metallicus, Inc., No. 4:19-CV-2250, 2020 WL 1672817, at *4 (S.D. Tex. Apr. 3, 2020).
80. *Id.* at *3.
81. *Id.*
82. *Id.*
83. Heinze v. Tesco Corp., 971 F.3d 475, 479 (5th Cir. 2020).
84. *Id.* at 480.
85. *Id.*
86. *Id.* at 481–82.

ally, because companies have no obligation to provide already existing information about commodity price trends, defendants "certainly had no obligation to include additional projections based on potentially inaccurate assumptions about future price trends."[87] By failing to allege a viable claim that the projections were misleading, the plaintiff was left with a pure omissions claim "untethered" to any misleading statement, which was ultimately not actionable.[88] The court also held that, in any event, the EBITDA projections fell within the PSLRA's safe harbor for forward-looking statements accompanied by meaningful cautionary language.[89] The court disposed of the fairness opinion summary for the same reasons as the EBIDTA projections.[90]

b. *Callinan v. Lexicon Pharmaceuticals*—Failure to Plead Actionable Misrepresentation

In *Callinan*, the shareholder lead plaintiffs argued that the defendant drug company violated Sections 10-b and 20 of the Exchange Act and Rule 10b-5 by fraudulently failing to disclose FDA concerns expressed about a clinical trial for one of the drugs it manufactured.[91] The court held that the plaintiffs' complaint did not contain facts showing when, where, to whom, or how the FDA made an actual communication demonstrating concern about a composite endpoint in a clinical trial that was available to defendants at the time the statement was made.[92] Accordingly, plaintiffs' allegations that the defendant's statements about achieving that endpoint were false and misleading were "not sufficiently particularized to state claim[s] for securities fraud by omission."[93] Furthermore, even if the misrepresentations were actionable, the plaintiffs failed to adequately plead scienter. The court found that plaintiffs' complaint lacked allegations of fact sufficient to establish that defendants either withheld information about the clinical trial's design, the results, or anything showing that defendants were aware of contrary information at the time the statement was made.[94] Thus, the court granted the defendants' motion to dismiss.[95]

c. *Heck v. Orion*—"Fraud by Hindsight" Insufficient to State an Exchange Act Claim

In *Heck v. Orion*, the class-action shareholder plaintiffs alleged that Orion Group Holdings violated Sections 10-b and 20a of the Exchange

87. *Id.* at 482 (citing Kapps v. Torch Offshore, Inc., 379 F.3d 207 (5th Cir. 2004)).
88. *Id.* at 483.
89. *Id.* at 483–84 (citing 15 U.S.C. § 78(u)-5(c)(1)(A)(i)).
90. *Id.* at 484–85.
91. Callinan v. Lexicon Pharms., Inc., 479 F. Supp. 3d 379, 403 (S.D. Tex. Aug. 14, 2020).
92. *Id.* at 405–06.
93. *Id.* at 406.
94. *Id.* at 431.
95. *Id.* at 442.

Act, as well as Rule 10-b because defendants (1) "improperly recognized revenue beyond what was authorized on the [c]ompany's contracts," falsified two years' worth of financial results and "reported significantly more revenue than the [c]ompany actually received," and (2) made public statements about the company's goodwill, doubtful accounts, estimates, or filed SOX certifications that were false or misleading.[96] However, the plaintiffs failed to plead any facts demonstrating how or why the statements were false when made. The court found that the statements of booking "significantly more revenue" than received were too vague to satisfy the pleading requirements for securities fraud when plaintiffs failed to make a showing as to the amount of revenue falsely booked or the reasons why it was false.[97] Further, the court did not accept plaintiffs' "fraud by hindsight" allegations that previous positive statements must have been false when made.[98] Accordingly, the plaintiffs failed to meet the heightened pleading requirements of the PSLRA.[99]

d. *Brooks v. United Development Funding III, LP*—Successful Pleading of Material Omissions

In a lengthy case examining TSA claims at the motion to dismiss stage, and after taking the plaintiffs allegations as true as required, the court found that the shareholder plaintiffs sufficiently plead most of their alleged claims on material misstatements and omissions for primary liability against entity defendants, and were narrowly sufficient in alleging control-person liability against entity and individual defendants.[100] However, the plaintiffs' pleadings were too conclusory to state a claim for aiding and abetting liability of the individual defendants and an auditing firm.[101]

Plaintiffs brought a putative class action alleging violations of the TSA in connection with the purchase and sale of securities offered by United Development Funding III, LP (UDF III) in its Dividend Reinvestment Plan (DRIP).[102] Plaintiffs sued several individuals and entities: (1) UDF III and many of its general partners, limited partners, and "advisors" to subsequent investing vehicles (collectively, the UDF Entity Defendants); (2) Whitley Penn LLP, an independent auditor for UDF III; and (3) high-ranking officers of UDF III and its general partners and asset managers (collectively, the UDF Individual Defendants).[103] Plaintiffs alleged that the UDF Entity and Individual Defendants made false and misleading public filings that lead them to "forego[e] receipt of cash distributions"

96. Heck v. Orion Grp. Holdings, Inc., 468 F. Supp. 3d 828, 851 (S.D. Tex. June 19, 2020).
97. *Id.*
98. *Id.* at 848–49.
99. *Id.*
100. Brooks v. United Dev. Funding III LP, No. 4:20-CV-00150-O, 2020 WL 6132230, at *25 (N.D. Tex. Apr. 15, 2020).
101. *Id.* at *28.
102. *Id.* at *2–3.
103. *Id.* at *2.

and instead used distributions to purchase additional stock.[104] Plaintiffs asserted both primary liability as against the UDF Entity Defendants and secondary "control-person" liability and "aiding and abetting" liability as against both the UDF Entity Defendants and Individual Defendants.[105]

Specifically, plaintiffs alleged various misstatements and omissions in the UDF Entity Defendants' offering materials that described their business. For example, they alleged UDF III was exceeding the Partnership Agreement's stated 20% cap on loans to any one borrower as reflected by UDF III's public filings, and representing in public filings that certain loans were fully collectible when such collection was doubtful.[106] Furthermore, plaintiffs contended that Whitley Penn aided and abetted these alleged violations by being in a position to know about "shifting loan proceeds among related entities" and certifying UDF III's financial statements anyway.[107]

First, the court dismissed entirely plaintiff Brooks's claims that were based on purchase of DRIP units between 2010 and 2013 as barred by the TSA's five-year statute of repose, and shortened the class-period to securities purchased from November 21, 2013, onward.[108] As to the remaining claims that were not time-barred, the UDF Entity Defendants moved to dismiss the primary liability TSA claim. The court denied most of the Entity Defendants' motion to dismiss, only granting the motion to dismiss the plaintiffs' primary liability TSA claim to the extent it was based on the alleged non-disclosure of an SEC investigation and alleged misrepresentations of future intent.[109]

UDF Entity Defendants argued that the plaintiffs failed to plead their allegations of fraud with particularity as required by Federal Civil Procedure Rule 9(b).[110] However, the court found that plaintiffs identified the documents that they contended were materially misleading, specified the time periods during which the documents were used to promote each offering, and described in detail the alleged false and misleading representations and the reasons why they were fraudulent.[111] Accordingly, they met their burden to plead with specificity at the motion to dismiss stage.[112]

The UDF Entity Defendants also argued that the public disclosures, which showed that UDF III made loans in conjunction with affiliates, negated the plaintiffs' claims for misstatements in their public filings.[113] The court disagreed, stating that, at least at the motion to dismiss stage, it was

104. *Id.* at *3.
105. *Id.* at *10.
106. *Id.* at *3–7.
107. *Id.* at *9.
108. *Id.* at *15. For further discussion of the TSA's statute of repose, see *infra* Section III.D.
109. *Id.* at *20–21.
110. *Id.* at *17.
111. *Id.*
112. *Id.* at *17–18.
113. *Id.* at *18–19.

not clear that a reasonable investor would have been aware from the public filings that Entity Defendants were using affiliates to loan money to UDF III, thus creating "the appearance of a successful series of real estate investment trusts."[114] With regard to the allegation that Entity Defendants' lent more than 20% of the capital contributions to one borrower, the court found that plaintiffs plausibly stated a claim by alleging certain years and borrowers for the alleged overspending.[115] However, the court dismissed the plaintiffs' claims to the extent they were based on Entity Defendants' alleged failure to disclose an SEC investigation because such an omission was not misleading when defendants did not have a duty to disclose the investigation.[116] Additionally, the court granted the motion to dismiss with respect to allegations of future intent also because the plaintiffs failed to allege scienter.[117]

With respect to "control-person liability" of the UDF Entity and Individual Defendants, the court found that the plaintiffs' allegations of fact regarding the common group of directors and officers, the individuals' senior or controlling positions within UDF III and its related entities, their power to control the form of UDF III's registrations and reports, and their access to non-public information were sufficient to withstand a motion to dismiss.[118]

As to the plaintiffs' claims against all three categories of defendants for aiding and abetting liability, the court held that "by a narrow margin," the plaintiffs' facts created a plausible inference of such liability only as the UDF Entity Defendants.[119] Facts that certain entities were the limited and/or general partners for each other or the "advisor" of certain UDF III affiliates, when combined with the other specific allegations set forth regarding misrepresentations, were sufficient to adequately plead aiding and abetting liability.[120] However, because the plaintiffs wholly failed to address the Individual Defendants' arguments supporting dismissal of their secondary liability claims, the court granted the UDF Individual Defendants' motion to dismiss based on aiding and abetting.[121] Similarly, the plaintiffs' allegations regarding Whitley Penn were too conclusory to withstand a motion to dismiss based on aiding and abetting liability because they rested almost entirely on Whitley Penn's status as an auditor.[122]

114. *Id.* at *19.
115. *Id.* at *20.
116. *Id.* at *20–21.
117. *Id.* at *22.
118. *Id.* at *24–25.
119. *Id.* at *26.
120. *Id* at *27.
121. *Id.* at *28.
122. *Id.*

3. *Failing to Adequately Allege Facts Showing Strong Inference of Scienter*

a. *Iron Workers Benefit & Pension Fund—Iron Workers Dist. Council Phila. & Vicinity v. Anadarko Petroleum Corp.*

In *Iron Workers*, the Fifth Circuit Court of Appeals affirmed dismissal of the shareholder plaintiff's complaint for failing to adequately allege scienter.[123] In a short opinion, the court found that the plaintiff's allegations that the defendant petroleum company "could not remotely monitor or deactivate about 800 of its 6,800 wells" as stated on its website, or that two company officers knew the company was not in compliance with applicable Colorado Oil and Gas Conservation Commission rules did not meet the heightened requirements of the PSLRA's pleading requirement.[124] The allegations were "merely consistent with liability," and neither gave rise to a strong inference of an "intent to deceive, manipulate, or defraud," nor evidence an action done with "severe recklessness" as required by the PSLRA.[125]

4. *Failing to Plead Around PSLRA's Safe Harbor*—Naglich v. Applied Optoelectronics

In *Naglich*, class action shareholder plaintiffs failed to avoid the PSLRA's safe-harbor for forward-looking statements by failing to plead facts showing defendants had actual knowledge of the falsity of its statements.[126] Plaintiffs alleged that the defendants concealed serious product defects causing the defendant to suspend all shipping under lucrative supply contracts and thus rendering their "putatively 'conservative'" earnings guidance in a press release and earnings call materially misleading.[127] The court found that the defendants' statements about future earnings trends were expressly qualified by statements such as, "the company currently expects" and "the views of management at the time such statements are made," which prevented any reasonable investor from viewing the earnings guidance as a "guaranty" or "assurance."[128] Further, the plaintiffs failed to adequately plead that the statements were not protected by the PSLRA safe harbor for forward-looking statements.[129] Though the plaintiffs alleged that the cautionary language included in the earnings guidance was "boilerplate" and thus insufficient to be afforded protection, the court concluded to the contrary; the cautionary language addressed factors that could cause the projections to materially differ,

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123. Iron Workers Benefit & Pension Fund—Iron Workers Dist. Council Phila. & Vicinity v. Anadarko Petroleum Corp., 788 F. App'x 268, 270 (5th Cir. 2019) (per curiam).
124. *Id.* at 269–70.
125. *Id.*
126. *See, e.g.*, Southland Sec. Corp. v. INSpire Ins. Sols., Inc., 365 F.3d 353, 371 (5th Cir. 2004).
127. Naglich v. Applied Optoelectronics, 436 F. Supp. 3d 954, 962 (S.D. Tex. Jan. 29, 2020).
128. *Id.* at 971.
129. *Id.* at 973.

such as reliance on a small number of customers, changes in demand, delays in shipments, and pricing pressure.[130] Moreover, even if the defendants did have a duty to update the earnings guidance as plaintiffs claimed, defendants updated their guidance seven weeks later—a reasonable time for investigation into the matter.[131]

D. Construing Statutes of Limitations and Statutes of Repose

The TSA's statute of limitations bars claims brought more than three years "after the discovery of the untruth or omission" underlying the alleged securities violation.[132] Additionally, the statute also bars claims brought "more than five years after the date of the sale" occurs.[133] Although the five year period is "titled" a statute of limitations, most courts characterize it as a statute of repose.[134] A five-year time bar is also applicable to criminal indictments for securities fraud.[135]

The time bars applicable to federal securities claims function similarly. Federal statute provides a statute of limitations for claims brought more than two years "after the discovery of the facts constituting the violation"[136] and a statute of repose that serves as an absolute bar to claims brought five years after the violation occurs, regardless of when the claim is discovered or injury ultimately occurs.[137] The limitations and repose periods often generate substantial litigation issues, giving rise to creative arguments about which actions (or series of actions) start the clock running on such periods, as exemplified in the cases below.

In *Williams v. State*, a Texas court considered whether the evidence was legally sufficient to support a finding that theft and securities fraud occurred "in aggregation, pursuant to one scheme or continuing course of conduct," under Texas Revised Civil Statute Annex art. 581-29-2.[138] In particular, the defendant argued that absent evidence of aggregation, he was charged outside of the five year statute of limitations period.[139] First, the court considered whether the evidence was legally sufficient to support aggregation, and found that a reasonable jury could have concluded

130. *Id.*
131. *Id.* at 974.
132. Tex. Rev. Civ. Stat. Ann. art. 581-33(H)(2)(a).
133. *Id.* art. 581-33(H)(2)(b).
134. Sistrunk v. Haddox, No. CV 18-516, 2020 WL 2549699, at *10 (W.D. La. May 19, 2020); Kubbernus v. ECAL Partners, Ltd., 574 S.W.3d 444, 476 (Tex. App.—Houston [1st Dist.] 2018, pet. denied).
135. Tex. Rev. Civ. Stat. art. 581-29-1.
136. 28 U.S.C.A. § 1658(b)(1) (West).
137. *See id.* § 1658(b)(2); McCann v. Hy-Vee, Inc., 663 F.3d 926, 930 (7th Cir. 2011) ("[A] period of repose bars a suit a fixed number of years after an action by the defendant (such as manufacturing a product), even if this period ends before the plaintiff suffers any injury"); *see also* Merck & Co. v. Reynolds, 559 U.S. 633, 650 (2010) (noting § 1658(b)(2) is an "unqualified bar on actions instituted '5 years after such violation'").
138. Williams v. State, No. 13-18-00454-CR, 2020 WL 1950864, at *8 (Tex. App.—Corpus Christi–Edinburg Apr. 23, 2020, pet. ref'd).
139. *Id.*

a "scheme or course of conduct" existed.[140] The court found that the defendant's method of defrauding investors was constant: he sold investor contracts involving commercial real estate transactions he promised would generate substantial returns, and then spent more than $100,000.00 of investor funds on personal expenses.[141] Accordingly, the court held that, since the limitations period ran from the time the last element of the last offense occurred pursuant to that scheme, the defendant was not indicted outside of the limitations period under the TSA, and his conviction would stand.[142]

In *Sistrunk*, the plaintiff filed suit in federal court against their former investment advisor, alleging that he churned their investment annuities for generating excessive fees for himself and a financial advising firm.[143] Plaintiffs brought various federal and state law claims, including a TSA violation and violation of Section 10(b) of the Exchange Act.[144] The court was tasked with determining when the defendant's alleged violations of the Exchange Act occurred in order to analyze whether the plaintiff's claims were time-barred by the statute of repose.[145] The court emphasized the difference between statutes of limitations, which begin to run when the claim accrues, and statutes of repose, which place an outer limitation on the right to bring an action measured from the date of the last culpable act or omission of the defendant.[146] The court found persuasive prior case law interpreting the statute of repose as applied to churning schemes.[147] In a prior case, the court held that the five-year statute of repose begins to run for churning scheme claims at the "moment the first sale or violation occurs, regardless of the claimant's discovery."[148] The court thus rejected the plaintiff's contention that the five-year statute of repose should not begin to run until the churning scheme was discovered or completed.[149] Accordingly, the court dismissed with prejudice the plaintiff's federal securities claims as time-barred.[150] With regard to plaintiff's claims under the TSA, the court held that they were similarly time-barred by Texas's five-year statute of repose.[151] The court also held that the TSA's definition of "securities" did not apply to annuities like the

140. *Id.* at *11.

141. *Id.* at *12.

142. *Id.*

143. Sistrunk v. Haddox, No. CV 18-516, 2020 WL 2549699, at *1 (W.D. La. May 19, 2020).

144. *Id.*

145. *Id.* at *7.

146. *Id.* at *6–7.

147. *Id.* at *8.

148. *Id.* (citing Escalon v. World Grp. Sec. Inc., No. 5:07-CV-214-C, 2008 WL 5572823, at *3 (N.D. Tex. Nov. 14, 2008)).

149. *Id.* at *8.

150. *Id.*

151. *Id.* at *10 (citing Tex. Civ. Rev. Stat. Ann. art. 581-33(H)(2)(b)). The court also noted that although the TSA titles the provision as a "limitations" period, the five-year time bar is generally characterized as a statute of repose. *Id.* (citing Kubbernus v. ECAL Partners, Ltd., 574 S.W.3d 444, 476 (Tex. App.—Houston [1st Dist.] 2018, pet. denied)).

ones at issue in the case.[152]

E. Receivership Issues

In *Zacharias v. Stanford International Bank*, the Fifth Circuit Court of Appeals affirmed the district court's approval of a settlement in a Ponzi scheme receivership and its entry of bar orders.[153] The SEC sued an investment company and its related entities for allegedly perpetrating a "massive, ongoing fraud" in the form of a Ponzi scheme.[154] The court appointed a receiver to marshal the assets of the investment company's entities, and it retrieved investment losses through various settlement agreements.[155] The plaintiff-objectors challenged the entry of the bar orders, arguing that the district court lacked jurisdiction to enter them.[156]

The Fifth Circuit remarked that equity receiverships are "older than this country," and that federal district courts are empowered by their securities law jurisdiction to utilize receiverships when the troubled company will likely be unable to satisfy its liabilities to its investors.[157] The court also noted that a receiver has broad power, but the receivership court "cannot reach claims that are independent and non-derivative" or that "do not involve assets claimed by the receivership."[158] Plaintiffs alleged that their claims were independent of the receivership, with some arguing that their claims sounded in tort or contract, or that the bar orders could not apply to their misrepresentation claims because the settling defendants had "direct contact" with them by "misrepresenting Stanford's financial soundness."[159] The court rejected the arguments by which plaintiffs attempted to distinguish themselves with different theories of liability.[160] According to the court, the objecting investors "rode the Receiver train until the end and then decided to hold up a settlement with a deep pocket."[161] Ultimately, the plaintiffs' claims were derivative of and dependent upon the receiver's, and the court refused to allow them to "jump the queue" and "escape pro rata distribution."[162] Thus, the court upheld the district court's bar orders and jurisdiction to enter them.[163]

IV. SUPREME COURT UPDATES AND OPEN QUESTIONS

The United States Supreme Court issued its highly anticipated decision in *Liu v. SEC*, a case addressing in what circumstances the SEC has au-

152. *Id.* (citing Tex. Rev. Civ. Stat. art. 581-4(A)).
153. Zacarias v. Stanford Int'l Bank, Ltd., 945 F.3d 883, 904 (5th Cir. 2019).
154. *Id.* at 889.
155. *Id.*
156. *Id.*
157. *Id.* at 895–96.
158. *Id.* at 897.
159. *Id.* at 899.
160. *Id.* at 900.
161. *Id.*
162. *Id.* at 902.
163. *Id.* at 902, 905.

thority to seek and obtain disgorgement as equitable relief. Additionally, three years after the Supreme Court issued its decision in *Lucia v. SEC*, questions regarding litigating securities law claims before administrative law judges continue to percolate throughout the lower courts.

A. *Liu* Decision

In *Liu v. SEC*, the Supreme Court considered the SEC's ability to obtain disgorgement as equitable relief in civil enforcement proceedings under Section 21(d) of the Exchange Act.[164] The Court ultimately held that disgorgement is permissible as "equitable relief" if it does not exceed the wrongdoer's illicit net profits and is returned to the wrongdoer's victims.[165]

Liu involved an investment scheme to defraud foreign investors that was operated by petitioners, Charles Liu and Xin Wang, who raised nearly $27 million from foreign investors seeking to qualify for United States visas by investing in United States businesses.[166] The trial court ordered Liu and Wang to disgorge the full amount of money they had raised from investors.[167]

Shortly after the trial court's decision in *Liu*, the Supreme Court decided in *Kokesh* that disgorgement was a "penalty" for statute of limitations purposes.[168] On appeal to the Ninth Circuit Court of Appeals and to the Supreme Court, petitioners relied heavily on *Kokesh*; arguing that because disgorgement was a "penalty" for purposes of the statute of limitations, it could not be "equitable relief" by definition.[169] However, the Supreme Court noted that its decision in *Kokesh* expressly leaves open the question of whether disgorgement is available as equitable relief.[170] Petitioners further argued that even if disgorgement was an available remedy, it was limited to net profits and not gross receipts, the lower court's rulings failed to account for their legitimate business expenses, and the decision failed to return the award to the investors.[171] For its part, the SEC contended that the main principle of equitable relief was to deprive the wrongdoer of ill-gotten gains, rather than return the profits to investors as a form of restitution.[172]

The Court held that disgorgement is permissible "equitable relief" that can be ordered in an SEC enforcement action in federal court if (1) the amount of the award does not exceed the wrongdoer's net profits, and (2) the money is awarded to the victims (not retained by the SEC).[173]

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164. Liu v. Sec. & Exch. Comm'n, 140 S. Ct. 1936, 1940 (2020).
165. *Id.*
166. *Id.* at 1941
167. *Id.* at 1937.
168. *Id.* at 1940 (citing Kokesh v. Sec. & Exch. Comm'n, 137 S. Ct. 1635, 1637 (2017)).
169. *Id.* at 1946.
170. *Id.*
171. *Id.* at 1947.
172. *Id.* at 1948.
173. *Id.* at 1949–50; *Supreme Court Permits SEC Disgorgement of Net Profits in* Liu v. SEC, Holland & Knight, LLP (June 22, 2020), https://media.hklaw.com/wp-content/

The Court's holding attempts to balance the countervailing considerations of equity: that wrongdoers should not be allowed to profit from their wrongdoing, nor should they be punished by paying more than fair compensation to the harmed person.[174] However, as explained in the Section below, questions regarding the court's restrictions on disgorgement awards remain—particularly in light of the National Defense Authorization Act (NDAA).[175]

B. NDAA Expressly Authorizes Disgorgement Actions, Expands Statute of Limitations, and Raises More Questions Post-*Liu*

Although the *Liu* decision upheld a federal court's authority to order disgorgement as equitable relief, until recently, there was no statutory authority to that effect. Congress attempted to pass legislation addressing the SEC's authority to pursue disgorgement in the federal court context. For example, House of Representatives Bill 4344, the Investor Protection and Capital Markets Fairness Act, passed the House in November 2019 by a vote of 314–95.[176] The bill sought to amend 15 U.S.C. § 78(u)(d) to authorize the SEC to seek disgorgement as a remedy for unjust enrichment and included a fourteen-year statute of limitations.[177] The Senate passed a similar bill except in that it contained a ten-year statute of limitations.[178] Ultimately, the NDAA, introduced on March 6, 2020, and signed into law over presidential veto on January 1, 2021, effectively mooted the prior House and Senate Bills.[179] Section 6501 of the NDAA expressly authorizes the SEC to seek "disgorgement . . . of any unjust enrichment by the person who received such unjust enrichment" because of securities law violations.[180] Notably absent from the NDAA is the Exchange Act's language that the Court analyzed in *Liu*—that equitable relief be "for the benefit of the investors."[181] Accordingly, this calls into question whether the SEC will be permitted to keep the disgorgement award rather than returning it to the investors.

Additionally, the NDAA extended the statute of limitations periods for seeking disgorgement awards. Specifically, for any violations that require

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uploads/2020/06/22160436/Client-Alert-Supreme-Court-Rules-in-Liu-v-SEC.pdf [https://perma.cc/NK46-BQFL].

174. *Supreme Court Permits SEC Disgorgement of Net Profits in* Liu v. SEC, *supra* note 173.

175. Daniel Walfish & Rachel Penski Fissell, *Exchange Act Amendments Would Bolster SEC Enforcement*, Law360 (Dec. 21, 2020), https://www.law360.com/articles/1339563/exchange-act-amendments-would-bolster-sec-enforcement [https://perma.cc/Q646-CHN7].

176. The Investor Protection and Capital Markets Fairness Act, H.R. 4344, 116th Cong. (2019–2020).

177. *Id.*

178. S. 799, 116th Cong. (2019).

179. H.R. 6395, 116th Cong. (2019).

180. National Defense Authorization Act, H.R. 6395, 116th Cong. § 6501(a)(1)(B), (a)(3) (to be codified at 15 U.S.C. § 78(u)(d)(3)(A)(ii), (d)(7)).

181. *Compare* 15 U.S.C. § 78(u)(d)(5), *with* National Defense Authorization Act, H.R. 6395, 116th Cong. § 6501(a)(3) (to be codified at 15 U.S.C. § 78(u)(d)(7)).

the SEC to prove the defendant's "scienter," (such as Section 10(b) of the Exchange Act,[182] Section 17(a) of the Securities Act of 1933,[183] and Section 206(1) of the Investment Advisor's Act of 1940[184]) the limitations period for seeking disgorgement is expanded to ten years from the last date of misconduct.[185]

C. An Open Question: Constitutionality of Litigating Claims Before Administrative Law Judges

In 2018, the Supreme Court decided *Lucia v. SEC*, where Raymond Lucia appealed an administrative law judge's (ALJ) ruling that he violated securities laws.[186] Lucia argued that the ALJ who decided his case was an officer of the United States, but was not appointed by the President, courts of law, or the heads of departments, as required by the Appointments Clause.[187] The Supreme Court agreed, holding that the proper remedy for the SEC's constitutional violation was to grant Lucia a new hearing before the SEC itself or before a new, constitutionally appointed ALJ.[188]

In the wake of *Lucia*, the SEC remanded "all proceedings currently pending before the Commission to the Office of Administrative Law Judges" to hold new hearings consistent with the Appointments Clause.[189] The defendant in one remanded case is Michelle Cochran, who the SEC alleges violated the Exchange Act.[190] Per *Lucia*, a new ALJ took Cochran's case. Cochran then filed suit in district court alleging in part a novel constitutional issue: that the restrictions on removing SEC ALJs violate separation of powers requirements under *Free Enterprise Fund v. PCAOB*.[191]

In *Free Enterprise Fund*, the SEC appointed all five members of the PCAOB (a governmental entity for constitutional purposes), and all five members were officers of the United States.[192] The statute mandated that the members could only be removed by the SEC "for good cause shown," and the SEC Commissioners could not be removed by the President except for "inefficiency, neglect of duty, or malfeasance in office."[193] The Supreme Court found that such a double-protection against removal vio-

182. 15 U.S.C. § 78(j)(b).
183. *Id.* § 77(q)(a)(1).
184. *Id.* § 80(b)-6(1).
185. National Defense Authorization Act, H.R. 6395 116th Cong. § 6501(a)(8)(A).
186. Lucia v. Sec. & Exch. Comm'n, 138 S. Ct. 2044, 2047 (2018).
187. *Id.*
188. *Id.* at 2048 (citing Ryder v. United States, 515 U.S. 177, 188 (1995)).
189. *In re* Pending Administrative Proceedings, Exchange Act Release No. 83907, 2018 WL 4003609 (Aug. 22, 2018) https://www.sec.gov/litigation/opinions/2018/33-10536.pdf [https://perma.cc/WP6N-6LJE].
190. Cochran v. Sec. & Exch. Comm'n, 969 F.3d 507, 510 (5th Cir.), *as revised* (Aug. 12, 2020), *reh'g en banc granted, opinion vacated*, 978 F.3d 975 (5th Cir. 2020).
191. *Id.* (citing Free Enter. Fund v. Pub. Co. Acct. Oversight Bd., 561 U.S. 477, 484 (2010)).
192. *Free Enter. Fund*, 561 U.S. at 477.
193. *Id.* (citing Humphrey's Executor v. United States, 295 U.S. 602, 620 (1935)).

lates separation of powers because the President "is no longer the judge of the Board's conduct. He can neither ensure that the laws are faithfully executed, nor be held responsible for a Board member's breach of faith."[194]

Similarly, Cochran alleged that SEC ALJs enjoy unconstitutional double-protection against removal.[195] The Fifth Circuit Court of Appeals heard oral argument on January 20, 2021 to determine whether a federal court has subject matter jurisdiction to hear Cochran's case before the conclusion of SEC administrative proceedings. Depending on how the Fifth Circuit rules, *Cochran* could again upend SEC adjudication and may spark congressional action.

V. LOOKING AHEAD: RULEMAKINGS, PREDICTIONS, AND CASES TO WATCH

A. Recently Adopted Rulemakings and Proposed Rules Attempt to Expand Access to Private Markets

1. Expanded Definition of "Accredited Investor" and Implications for Investors and Issuers

Under federal securities laws, offers and sales of securities must be registered with the SEC, unless an applicable exemption applies.[196] In October 2020, the SEC promulgated a final rule that revised and broadened the definition of an "accredited investor" under the Securities Act of 1933.[197] An accredited investor is a person or entity permitted to invest in securities without registration from the SEC if that person or entity meets certain income or net worth guidelines.[198] Essentially, these persons are deemed to have the knowledge and expertise to participate in private markets.[199] The final rule, effective as of December 8, 2020, expanded the definition to include new categories of "natural persons" and entities who qualify as accredited investors.[200]

As to natural persons, the definition of "accredited investor" now includes persons holding certain professional licenses;[201] a person considered a "knowledgeable employee"[202] of the issuer of the securities being offered or sold, as that term is defined in Rule 3c–5(a)(4) of the Invest-

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194. *Id.*
195. *Cochran*, 969 F.3d at 510.
196. *See* 15 U.S.C. § 77(e).
197. 85 Fed. Reg. 64234 (Oct. 9, 2020) (to be codified at 17 C.F.R. pts. 230, 240).
198. *See Amendments to Accredited Investor Definition*, Sec. & Exch. Comm'n, https://www.sec.gov/corpfin/amendments-accredited-investor-definition-secg (last modified Dec. 8, 2020); 85 Fed. Reg. 64234, 64235 (Oct. 9, 2020) ("Qualifying as an accredited investor, as an individual or an institution, is significant because accredited investors may, under Commission rules, participate in investment opportunities that are generally not available to nonaccredited investors, including certain investments in private companies and offerings by certain hedge funds, private equity funds, and venture capital funds.").
199. *Amendments to Accredited Investor Definition*, *supra* note 198.
200. *Id.*
201. 17 C.F.R. § 230.501(a)(10).
202. *Id.* § 230.501(a)(11).

ment Company Act of 1940; or a "family client" of a "family office" pursuant to the definitions in the Investor Adviser's Act.[203] With regard to new categories of qualifying entities, the new rule expanded the definition to include "SEC-and state-registered investment advisers, rural business investment companies, limited liability companies, family offices, family clients," and a catch-all category, to include entities owning investments exceeding $5 million.[204]

The new categories signal a shift from using accumulated wealth as a "proxy of financial sophistication" to considering experience and overall ability to assess investment opportunities.[205] For issuers of securities, this new definition could potentially expand the number of persons and entities to whom they can offer or sell securities to without the additional expense of registration. The SEC anticipates that the rule amendments will reduce search costs of finding investors due to a potentially lower cost of determining and verifying accredited investor status.[206] On the investor side, individuals and entities swept into the definition under the new rules will be able to access investment opportunities previously unavailable to them, including private equity, venture capital, and hedge fund offerings.[207] Such opportunities are significant—in 2019, an estimated more than $1.5 trillion in capital was raised through unregistered offerings as compared to $1.2 trillion raised through registered offerings.[208]

In November 2020, the TSSB also proposed an amendment to its rules to bring its definition of "accredited investor" into alignment with the SEC's definition.[209] The new rule exempts persons who offer or sell securities to accredited investors or render investment advice to accredited investors from the registration requirements of the TSA.[210] The TSA adopted these rules in March 2021.[211]

2. *Proposed Rule Creating "Finder" Exception to Requirement to Register as a Broker and Implications for Enforcement*

Additionally, in October 2020, the SEC proposed (but as of this writing, has not adopted) a new rule that would allow natural persons to engage in limited capital raising activities (finders), and receive transaction-based compensation, without having to register with the SEC as a

203. *Id.* § 230.501(a)(13).

204. 85 Fed. Reg. 64234, 64245–51 (Oct. 9, 2020) (codified at 17 C.F.R. § 230.501(a)(1), (a)(12)).

205. *See id.* at 64234, 64235.

206. *See id.* at 64234, 64260.

207. *See id.*

208. *See id.* at 64234, 64259.

209. 45 Tex. Reg. 7822, 7823 (2020) (to be codified at 7 Tex. Admin. Code § 107.2) (proposed Nov. 6, 2020) (Tex. State Sec. Bd., Terminology).

210. *Id.*

211. 7 Tex. Admin. Code §§ 107.2, 109.4, 109.5, 109.6 (2021) (Tex. State Sec. Bd., Terminology).

broker.[212]

Due to their roles as intermediaries between customers and securities markets, brokers are required to register with the SEC unless an exception or exemption applies.[213] The Exchange Act currently broadly defines "brokers" to mean "any person [or entity] engaged in the business of effecting transactions in securities for the account of others . . . ."[214] The Exchange Act does not define what it means to be "engaged in the business of effective transactions in securities."[215] In examining broker status, courts and the SEC itself have found determining "broker" status is a fact-intensive inquiry, with a key consideration being the individual's "regular participation" in securities transactions "at key points in the distribution."[216]

Many individuals alleged to have violated the registration rules applicable to brokers argue that they were not "brokers," but rather "mere finders"—essentially "matchmakers" for investors and issuers who facilitated introductions.[217] However, the SEC currently does not recognize this "mere finder" type of exemption, and courts have reached uneven results on the issue.[218] Some have found solicitation of investors does subject the soliciting individual to the broker requirements,[219] while others have found that "merely bringing together" individuals as part of a securities transaction is "not enough" to incur liability.[220]

The proposed rule would clarify the confusion surrounding the broker definition by creating exemptions for two tiers of natural persons considered "finders."[221] For both tiers, the exemption would only be applicable if:

- The issuer is not required to file reports under Section 13 or Section 15(d) of the Exchange Act;
- The issuer is seeking to conduct the securities offering in reliance on an applicable exemption from registration under the Securities Act of 1933;
- The Finder does not engage in general solicitation;

212. *See* 85 Fed. Reg. 64542 (Oct. 13, 2020).
213. *See* 15 U.S.C. § 78(o)(a).
214. *See id.* § 78(c)(a)(4)(A).
215. *See id.* § 78(c)(a).
216. *See, e.g.*, U.S. S.E.C. v. Bravata, No. 09-12950, 2009 WL 2245649 (E.D. Mich. July 27, 2009) (internal citations omitted).
217. *See* 85 Fed. Reg. 64545 n. 45.
218. *See* 85 Fed. Reg. 64542, 64545 (Oct. 13, 2020).
219. *See, e.g.*, S.E.C. v. Helms, No. A-13-CV-01036, 2015 WL 5010298, at *17 (W.D. Tex. Aug. 21, 2015) ("In determining whether a person 'effected transactions [for purposes of the Exchange Act registration requirements],' courts consider several factors, such as whether the person: (1) [s]olicited investors to purchase securities[;] (2) was involved in negotiations between the issuer and the investor[;] and (3) received transaction-related compensation.").
220. Apex Glob. Partners, Inc. v. Kaye/Bassman Intern. Corp., No. 3:09-CV-637-M, 2009 WL 2777869, at *3 (N.D. Tex. Aug. 31, 2009) ("Merely bringing together the parties to transactions, even those involving the purchase and sale of securities, is not enough" to warrant broker registration under Section 15(a)).
221. *See* 85 Fed. Reg. 64542, 64546 (Oct. 13, 2020).

- The potential investor is an "accredited investor" as defined in Rule 501 of Regulation D or the finder has a reasonable belief that the potential investor is an "accredited investor";
- The finder provides services pursuant to a written agreement with the issuer that includes a description of the services provided and associated compensation;
- The finder is not an associated person of a broker-dealer; and
- The finder is not subject to statutory disqualification, as that term is defined in Section 3(a)(39) of the Exchange Act, at the time of his or her participation.[222]

Importantly, the proposed rule narrowly construes these exemptions to apply only to "finders" soliciting investments for companies who are not required to register their securities with the SEC, and they can only engage with potential investors who the finder knows or reasonably believes to be an "accredited investor."[223] This evidences the balance between expanding access to investment opportunities in private markets while limiting those opportunities to sophisticated investors who can assess and bear the associated risk.

The proposed rule also delineates permissible activities for each tier of "finder." For example, Tier I finders would be limited to providing the issuer with potential investor's contact information—and for that, only "in connection with one capital-raising transaction for a single issuer in a twelve-month period."[224] Tier II finders are entitled to engage in broader activities, but are subject to heightened requirements. Tier II finders are limited to "(i) [i]dentifying, screening, and contacting potential investors; (ii) distributing issuer offering materials to investors; (iii) discussing issuer information included in any offering materials," as long as they do not provide advice regarding the valuation or advisability of the investment; and (iv) arranging meetings between the issuer and investor.[225] A Tier II finder would also be required to disclose information about their role and compensation in the transaction, as well as to obtain the potential investor's written acknowledgment of receipt of such disclosures.[226] The SEC proposed the proposed rule in recognition of the declining number of registered broker-dealers, particularly those willing to find investors to help businesses raise capital when the amount of investment sought by the business falls below $5 million.[227] The proposed rule is an attempt to bridge the gap for businesses seeking less capital than required to attract large broker-dealers, but more than the amount that could be provided through personal network and fundraising efforts.[228]

222. *Id.* at 64546–47.
223. *Id.* at 64547.
224. *Id.* at 64548.
225. *Id.* at 64548–49.
226. *Id.*
227. *See id.* at 64543.
228. *See id.*

If the rule is adopted, it stands to reason that enforcement activities for violators of the registration requirements will decrease as more persons qualifying as "finders" can be exempt from the registration requirements. However, it should be noted that exemption from registration does not exempt "finders" from the anti-fraud provisions of the Act.[229]

B. Cases to Watch

The TSA's mandate that registered firms report suspected exploitation of elderly and vulnerable victims[230] lead to a report against Metals.com, a precious metals dealer who defrauded elderly investors into purchasing overpriced gold and silver. TSSB settled the matter with Metals.com, who agreed to refund eighty-four Texas investors in July 2019.[231] Later, however, the CFTC, the State of Texas, and twenty-nine other states and state regulators filed suit in the Northern District of Texas, alleging Metals.com fraudulently solicited and received more than $185 million in customer funds, most of which were retirement savings.[232] Plaintiffs secured a temporary restraining order against Metals.com on September 22, 2020, which froze Metal.com's assets and appointed a temporary receiver.[233] This case may be one to watch as it makes its way through the litigation process in 2021.

C. SEC's Focus for Upcoming Year

1. *SEC Reviews Environmental, Social, and Governance Disclosures in Effort to Update Guidance*

In early 2021, the Acting Chair of the SEC, Allison Herren Lee, issued a directive to the Division of Corporate Finance to "enhance its focus on climate-related disclosures" in company public filings.[234] In particular, she directed the staff to review public companies' compliance and addressing of topics identified in the SEC's 2010 guidance.[235] Through insights garnered during this process, the Division will begin to update the

229. Andrew May, *New Proposed SEC Rule Would Allow Finders to Receive Commissions Without Registering as a Broker Dealer*, JD Supra (Nov. 4, 2020), https://www.jdsupra.com/legalnews/new-proposed-sec-rule-would-allow-89959/#:~:text=IN%20order%20to%20clarify%20various,in%20raising%20money%20by%20private [https://perma.cc/XZ8K-DGWB].

230. Tex. Rev. Civ. Stat. Ann. art. 581-45(B).

231. *Metals.com to Offer Full Refunds to Texas Investors in Deal Likely to Exceed $10 Million*, Tex. State Sec. Bd. (July 1, 2019), https://www.ssb.texas.gov/news-publications/metalscom-offer-full-refunds-texas-investors-deal-likely-exceed-10-million [https://perma.cc/3YX7-3EDM].

232. Plaintiff's Petition, Comm. Futures Trading Comm'n v. TMTE, Inc., No. 3:20-CV-02910-L (Sept. 22, 2020).

233. Order Granting Plaintiffs' Emergency Ex Parte Motion for Statutory Restraining Order, Appointment of Receiver, and Equitable Relief, Comm. Futures Trading Comm'n v. TMTE, Inc., No. 3:20-CV-02910-L (Sept. 22, 2020).

234. Allison Herren Lee, *Statement on the Review of Climate-Related Disclosure*, SEC.gov (Feb. 24, 2021), https://www.sec.gov/news/public-statement/lee-statement-review-climate-related-disclosure [https://perma.cc/E892-2TAD].

235. *Id.*

2010 guidance and account for developments over the past decade, with an ultimate goal of creating a framework for consistent climate-related disclosures.[236]

In the enforcement arena, this could mean an uptick in enforcement actions related to failure to disclose to investors information that implicates climate risk. Additionally, companies are likely waiting for detailed guidance related to the scope and form of the disclosures required. The SEC's new disclosure requirements are likely to be required on quarterly and annual reports—but the SEC could also go as far as to require these disclosures in proxy statements to shareholders.[237] Companies should be ready to assess the Environmental, Social, and Governance (ESG)-related impacts of their businesses including operations, greenhouse gas emissions, and even expenditures to combat climate change.[238]

D. SEC Policy Changes in Light of New Presidential Administration

1. Delegated Authority and Re-empowerment of Staff

In addition, Acting Chair Allison Lee issued a statement authorizing the re-empowerment of senior officers at the Commission.[239] The acting chair authorized senior officers to approve the issuance of a formal order of investigation, thereby allowing them to invoke the delegated authority of the Commission in permitting staff to "subpoena documents and take sworn testimony."[240] According to Lee, this will help the Commission more swiftly and efficiently investigate ongoing frauds during a time where the pace of such frauds is increasing rapidly.[241]

Lee's action demonstrates a return to the pre-Trump era authority of the Commission, signaling a turn to a potentially more assertive SEC under the Biden administration.[242] Under former President Trump, the SEC's number of new investigations fell every year.[243] With this re-empowerment of staff, we could see an uptick in enforcement and potentially a return to pre-Trump-era numbers in the years ahead.

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236. *Id.*

237. Louis Rambo & Frank Zarb, *Expect New SEC Leadership to Require More ESG Reporting*, JD Supra (Jan. 12, 2021), https://www.jdsupra.com/legalnews/expect-new-sec-leadership-to-require-6303414/ [https://perma.cc/PBG6-F5QP].

238. *See id.*

239. Allison Herren Lee, *Statement of Acting Chair Allison Herren Lee on Empowering Enforcement to Better Protect Investors*, U.S. Sec. & Exch. Comm'n (Feb. 9, 2021), https://www.sec.gov/news/public-statement/lee-statement-empowering-enforcement-better-protect-investors [https://perma.cc/3NS7-66Z2].

240. *Id.*

241. *Id.*

242. Dave Michaels, *SEC Expands Enforcement Staff's Power to Start New Investigations*, Wall St. J. (Feb. 9, 2021, 6:22 PM), https://www.wsj.com/articles/sec-expands-enforcement-staffs-power-to-start-new-investigations-11612894490 [https://perma.cc/EE8Q-D45V].

243. *Id.*

2. *Separation of Waiver and Settlement Recommendation Process*

In another return to prior SEC practices, Acting Chair Lee also reinforced the separation between the SEC's enforcement process and consideration of requests for waivers from disqualifications.[244] Certain securities law violations trigger automatic disqualifications from privileges, such as being considered a "Well-Seasoned Known Issuer" (WSKI) or participating in private offerings under Rule 501 Regulation D.[245] The SEC has the discretion to grant waivers of such disqualifications.[246] Many WKSIs are large banks or corporations who rely on these waivers to be able to continue to participate in private offerings—and they often seek waivers in conjunction with their settlement offers. The Acting Chair explained that best practices are to separate the consideration of waivers applications from the considerations related to settlement of enforcement cases.[247] Accordingly, the enforcement division "will no longer recommend to the Commission a settlement offer that is conditioned on granting a waiver," and the Corporate Finance and Investment Division will instead review such waivers under "separate and distinct" standards.[248]

However, not everyone at the Commission is on board with the change to the settlement and waiver process. Two commissioners voiced their dissent with Acting Chair Lee's statement, indicating their support for the Commission's policy of considering and accepting contingent settlement offers.[249] While Acting Chair Lee expressed that the process should not be used as a negotiation tool,[250] Commissioners Peirce and Roisman countered that accepting contingent settlement offers "acknowledges the reality that an entity's willingness to reach a prompt settlement on just and fair terms often is influenced by its concerns regarding the potential collateral consequences of entering into the settlement."[251] They suggested that entities would likely be less willing to settle if "left in the dark" about their waiver application status.[252] Furthermore, they emphasized that the policy has worked out well, increased efficiency, and has not introduced any "structural conflicts or pressures" between the Division of Investment Management and the Division of Corporation Finance, and that returning to the prior process will "result in a longer period between the initiation and resolution of enforcement matters."[253]

244. Allison Herren Lee, *Statement of Acting Chair Allison Herren Lee on Contingent Settlement Offers*, SEC.GOV (Feb. 11, 2021), https://www.sec.gov/news/public-statement/lee-statement-contingent-settlement-offers-021121 [https://perma.cc/4L3B-792P].
245. *Id.*
246. *Id.*
247. *Id.*
248. *Id.*
249. Hester M. Peirce & Elad L. Roisman, *Statement of Commissioners Hester M. Peirce and Elad L. Roisman on Contingent Settlement Offers*, SEC.GOV (Feb. 12, 2021), https://www.sec.gov/news/public-statement/peirce-roisman-statement-contingent-settlement-offers-021221 [https://perma.cc/LT8N-25RS].
250. Lee, *supra* note 239.
251. Peirce & Roisman, *supra* note 249.
252. *Id.*
253. *Id.*

Whether the concerns raised by the dissenting commissioners will result from the separation of the waiver and settlement process remains to be seen. However, now that companies cannot ask for a waiver when it offers to settle and subsequently revoke its settlement offer if the Commission declines to grant a waiver—more companies will have to consider whether to invest in long-haul litigation. Furthermore, this policy signals that the SEC intends to be more aggressive from an enforcement standpoint and possibly more reluctant to grant waivers in the future.[254]

3. Division of Examinations Priorities

Each year for the past eight years, the SEC's Division of Examinations (EXAMS, formerly, the Office of Compliance Inspections and Examinations (OCIE)[255]), announces its examination priorities for the upcoming fiscal year to identify key risks, trends, and priorities it will assess as part of its overall mission to protect investors and monitor compliance.[256] For Fiscal Year 2021, EXAMS identified several key areas that provide valuable insights about what the future holds regarding enforcement trends and possible sweep initiatives.

Perhaps unsurprisingly, considering the market volatility experienced over the past year and related pressures, EXAMS indicated a focus area of fraud and sales practices, particularly with an eye to broker-dealers, investment companies, and registered investment advisors' standards of conduct.[257] Additionally, in light of the new rule revising the definition of "accredited investor," EXAMS will also examine compliance related to those changes when selling private offerings.[258] As part of its retail-targeted investments priority, EXAMS announced its commitment to "deterring microcap fraud, or fraud in connection with securities of companies with a market capitalization under $250 million."[259] Because the prior year saw various issuers of such securities make dubious claims related to COVID-19 testing, treatments, and vaccines, EXAMS stated it would continue to monitor these circumstances.[260]

EXAMS will continue to review the compliance programs of both registered investment advisors and investment companies.[261] Of particular note is the continued priority of ESG-factors.[262] EXAMS indicated that registered investment advisors are "increasingly offering" strategies with

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254. *SEC Reverses Position on Accepting Settlement Offers Contingent on Waivers, Creating Once Again Risk That Defendants Will Be Forced to Make Settlement Decision with Significant Uncertainty*, SHEARMAN & STERLING (Feb. 18, 2021), https://www.lit-wc.shearman.com/sec-reverses-position-on-accepting-settlement-offers-contingent [https://perma.cc/JT9D-5C2Y].

255. DIV. EXAMS., U.S. SEC. & EXCH. COMM'N, 2021 EXAMINATION PRIORITIES 1 (2021), https://www.sec.gov/files/2021-exam-priorities.pdf [https://perma.cc/8K42-FMVE].

256. *Id.*

257. *Id.* at 21.

258. *Id.*

259. *Id.* at 23.

260. *Id.*

261. *Id.* at 28.

262. *Id.*

reference to terms like "sustainable, socially responsible, impact, and ESG conscious."[263] Accordingly, EXAMS intends to prioritize review of these strategies and adequacy of disclosures to ensure alignment between them.[264]

In response to the work-from-home environment occasioned by the pandemic, EXAMS will also address information security because of the critical role it plays in the financial market's operation.[265] EXAMS will monitor whether firms have taken adequate precautions to safeguard customer data, respond to data breaches, and manage operational risk as their employees work remotely.[266] Relatedly, EXAMS will examine firms' "business continuity and disaster recovery plans," particularly in light of large-scale climate events.[267]

E. Predictions

As the pandemic-related economic fallout continues, we are likely to see an increase in COVID-19 related lawsuits, including securities class actions. This is especially likely given the SEC's guidance from April encouraging public companies to disclose as much information as practicable concerning their financial and operations status.[268] The SEC has already shown its willingness to bring enforcement actions based on failures to disclose—and class-action litigation based on the same may not be far behind. We are still at the beginning stages of watching the unwinding of COVID-19-related fraud make its way through the court system, the aftermath of which is likely to play out over the next several years.

VI. CONCLUSION

The onset of the COVID-19 pandemic in 2020 launched a flurry of enforcement actions related to securities fraud—both directly related to fraudulent healthcare technology schemes and for public companies' failures to disclose the economic effects of the pandemic on their businesses to investors. In Texas, state securities enforcement was likewise active, with the TSSB expectedly continuing its focus on cryptocurrency, binary and foreign exchange options, and oil and gas, this year with the added overlay of COVID-19-related frauds. Although a relatively slow year in terms of private litigation and class action lawsuits, the cases that did make their way through the courts this year still provided valuable insight into pleading deficiencies common in bringing securities class action suits. In TSA cases, we saw a judicial reluctance to create a common law cause

263. *Id.*
264. *Id.*
265. *Id.* at 24.
266. *Id.*
267. *Id.* at 25.
268. *See* Jay Clayton & William Hinman, *Chair Corp. Fin., The Importance of Disclosure—For Investors, Markets and Our Fight Against COVID-19*, U.S. Sec. & Exch. Comm'n (Apr. 8, 2020), https://www.sec.gov/news/public-statement/statement-clayton-hinman [https://perma.cc/982U-8FDY]; *see also supra* Section II.B.

of action for aiding and abetting fraud, but the continued limitation of the Texas Anti-SLAPP statute. The United States Supreme Court also rendered its highly anticipated *Liu* decision, which outlines guidelines for seeking disgorgement. The subsequent passage of the NDAA statutorily enshrined the SEC's ability to seek disgorgement and bolstered the SEC's authority—but raises the question of whether, under *Liu*, the profits must be returned to the investors, because the statute is silent to that effect.

Additionally, the political impacts of the 2020 election of President Biden and his new administration suggest a return to a more aggressive SEC. Re-empowerment of staff and directives by the Acting Chair to focus on ESG disclosures likely foreshadow the number and types of enforcement actions that may unfold in the coming months and years.