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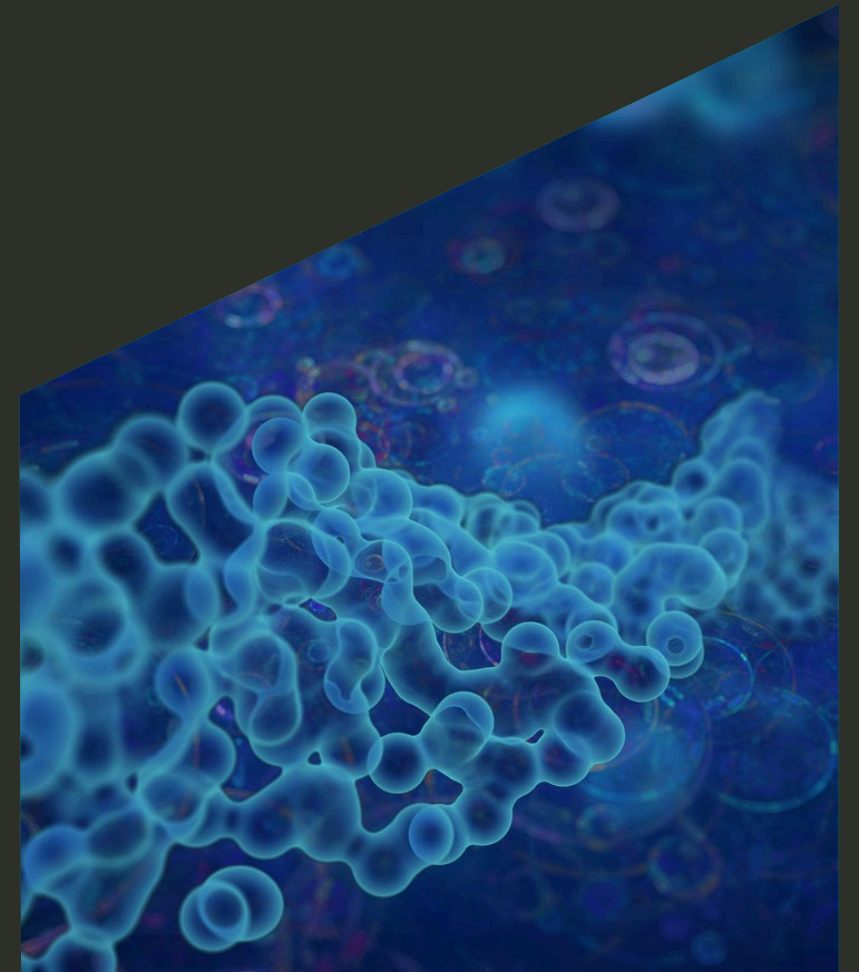


SEC ENFORCEMENT TRENDS AND FCPA

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AGENDA

Public Company Developments

Accounting and Disclosure Actions

Insider Trading

FCPA

Resources





PUBLIC COMPANY DEVELOPMENTS

SEC

- SEC Enforcement Division handles civil enforcement of the federal securities laws
 - Securities Act of 1933
 - Securities Exchange Act of 1934
- Enforcement Division lawyers investigate potential violations
- Based on investigation, Division may recommend that the Commission authorize an action in federal court or administrative forum
- Charges can result in negative publicity, bars, and monetary relief

DOJ

- DOJ and USAO handles criminal enforcement of federal laws
- Fraud Section
 - FCPA Unit
 - Health Care Fraud Unit
 - Securities and Financial Fraud Unit
- Work alongside SEC and other regulators
- Range of fraud cases
 - Focus on more egregious conduct
 - Higher burden of proof

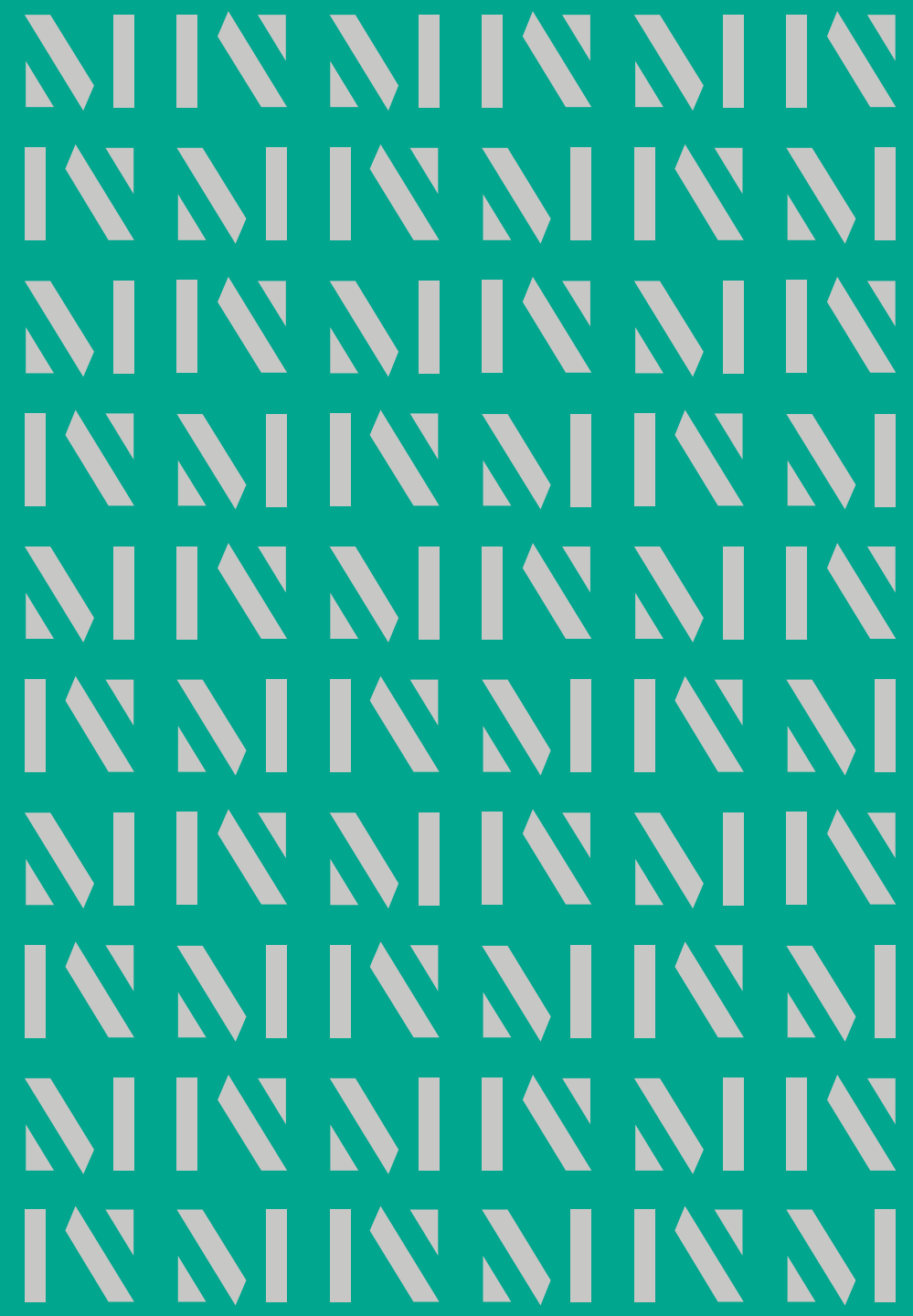
SEC ENFORCEMENT TRENDS

- Commission and Enforcement Director transition
- NDAA statute of limitations
- Other trends
 - ESG
 - Covid-19
 - Non-GAAP measures
 - Impairment
 - EPS initiative
 - Cybersecurity
 - Internal Controls

NOTE

- Cases that we will discuss are based on SEC allegations
- SEC subjects often settle without admitting or denying allegations
- Some parties are litigating
- Providing an overview, rather than every detail

ACCOUNTING AND DISCLOSURE INVESTIGATIONS



FOCUS OF ACCOUNTING FRAUD INVESTIGATIONS

- Misstatements or misleading omissions
 - GAAP violations
 - Other disclosures
- Quantitative and qualitative materiality
- State of mind
 - Intentional conduct and recklessness
 - Negligence
- Responsible party and individual liability

MEDICAL TESTING STARTUP

- SEC charged 2 executives of private medical testing company
- Alleged **improper insurance billing practices** to inflate revenue
 - Website portal did not establish sufficient doctor-patient relationship
 - Retested old samples
 - Falsified records
 - Manipulated and misused billing records
- Allegedly raised \$60 million in Series C round by **falsely portraying successful health insurance reimbursements**
- Pursuing fraud charges, disgorgement, penalties, and bars
- Litigated matter and parallel criminal action

COVID CLAIMS

- Action against biotechnology company and its CEO
- According to SEC, company falsely claimed in press releases that it had developed a finger-prick blood test that could detect Covid-19
- SEC also alleged false claims about **progress towards FDA emergency use authorization**
- Advisors warned that testing kit would not work as described
- SEC suspended trading after surges in price and volume
- In litigated action, SEC sought fraud injunction, penalties, officer-and-director bar, and penny stock bar
- Parallel criminal action

BIOTECHNOLOGY COMPANY

- Charges against biotechnology company and 3 former executives
- SEC alleged that company prematurely recognized revenue from **sales to distributors** and exaggerated revenue growth
- Undisclosed **side agreements** allowed distributors to return product or conditioned payments based on sales to end users
- Former controller raised concerns
- Executives misled auditors and internal investigation team

BIOTECHNOLOGY COMPANY

- Fraud, reporting, books-and-records, and internal controls charges
- Company received **credit for remediation and cooperation**, but still paid \$1.5 million penalty
- SEC also charged individuals with **lying to auditors** and sought injunctions, disgorgement, penalties, officer-and-director bars, and clawbacks
- Parallel criminal action

PHARMACEUTICAL COMPANY

- Action against pharmaceutical company and 3 former executives
- SEC alleged **improper revenue recognition** and misleading disclosures in SEC filings and earnings presentations
 - Touted same-store organic growth, a **non-GAAP measure**, without disclosing unique relationship to mail order pharmacy established by company
 - **Misallocated revenue** from wholesale price increase to unrelated products
- Settled to negligence-based charges and Regulation G violations
- Company: \$45 million penalty
- Individual liability: penalties, clawbacks, and an accountant bar
- Cooperation

PRACTICAL GUIDANCE

- SEC focused on problematic efforts to meet overly aggressive expectations and an unwillingness to disclose shortcomings
- Common feature of accounting concerns related to distributor relationships and sales
- Increased attention to internal controls
- Not just company exposure: Risk of individual liability and parallel criminal action

INSIDER TRADING



INSIDER TRADING

- Illegal insider trading refers generally to buying or selling a security on the basis of **material, nonpublic information** (MNPI) about the security, **in breach of a fiduciary duty or other relationship of trust and confidence**
- Extends to public and private companies
- Prosecutorial priority for both SEC and USAO
- Investigations carry significant cost, even with no charges
- Business risks: Key player exposure, negative publicity, and loss of trust

BASIC INSIDER TRADING CONCEPTS

- Prosecuted under Rule 10b-5, a general antifraud provision
- **Classical theory:** CEO or other insider trades on a market-moving event ahead of her own company's shareholders
- **Constructive insiders:** Professionals hired to assist a company trade on material information entrusted to them
- **Misappropriation theory:** Individual trades in breach of a duty of trust or confidence owed to source of information
- **Tipping:** Extends classical, constructive, and misappropriation theories to cover trading through someone else
- **STOCK Act:** Concerned with trading by representatives and staff

TRENDS IN INSIDER TRADING

- The SEC has dedicated **substantial resources** to identifying and investigating potential insider trading
 - Market Abuse Unit
 - Use of Proprietary Technology
 - Potential Internal Controls Violations
- 18 USC § 1348 – Securities and Commodities Fraud

RECENT INSIDER TRADING ACTIONS

- California husband and wife in an alleged multi-million-dollar insider trading scheme involving the securities of a pharmaceutical concern in advance of an **announcement about the company's acquisition**
- Former executives of a pet pharmacy for allegedly trading in advance of **market-moving earnings announcements**
- Former Controller of a company involved in the generic pharmaceutical business for allegedly trading ahead of **earnings results showing poor sales and a pending impairment charge**
- Two former employees of a large pharmacy chain for allegedly disposing of shares prior to a negative announcement regarding the **status of a potential merger**

INTERNAL CONTROLS

- Public company engaged in acquisition negotiations
- Those talks were suspended, but then reengaged months later
- Immediately before talks resumed, CEO directed the CFO to initiate a \$250 million stock buyback
- Board's authorization of the buyback was subject to a policy prohibiting stock purchases while in possession of material nonpublic information
- **Rather than charge the company with fraud, the SEC alleged that the company failed to maintain sufficient internal accounting controls**
- Process allegedly was “abbreviated and informal” and did not sufficiently engage the CEO
- SEC imposed a **\$20 million penalty**

RECENT DEVELOPMENTS

- 18 USC § 1348 – Securities and Commodities Fraud
 - Added to the Criminal Code in 2002 as part of Sarbanes-Oxley Act
 - Statute received little, if any, attention when it was enacted
- DOJ started bringing charges under this statute in the last few years
- Courts have interpreted this statute to have less stringent requirements than Section 10(b)
- Government allegedly does not have to prove a “personal benefit”

US VS. BLASZCZAK

- Blaszczak, a former government employee turned political intelligence consultant, allegedly obtained details about upcoming CMS decisions from close friend and former colleague at CMS
- Allegedly supplied information to a hedge fund that used the information to trade the stock of affected healthcare firms, obtaining at least \$4 million in profits
- Criminally charged with insider trading under Section 10(b) and 18 USC § 1348
- Following mixed verdict after trial, Blaszczak appealed

US VS. BLASZCZAK

- Second Circuit upheld the conviction for securities fraud under Title 18 of the criminal code, notwithstanding that he was acquitted on insider trading charges under Section 10(b)
 - No personal benefit requirement under Title 18
 - “Predecisional” information was property that could be misappropriated
- Supreme Court vacated the Second Circuit’s decision and remanded the case for further consideration in light of *Kelly vs. United States*
- Supreme Court did not reach the merits of *Blaszczak*’s other significant holding—that tipping schemes charged under Title 18 do not need to satisfy the same requirements for insider trading cases charged under Section 10(b), including the “personal benefit” requirement

REGULATION FD

- Regulation FD addresses the selective disclosure of information by publicly traded companies and other issuers
- When an issuer discloses MNPI to certain individuals or entities—generally, securities market professionals, such as stock analysts, or individual investors who may well trade on the basis of the information—the issuer must also make public disclosure
- Recent litigated action against large public company
 - Alleged attempts to influence consensus estimates
 - Investor relations personnel allegedly disclosed product sales data
- Historical action against a pharmaceutical company selectively sharing information about an FDA meeting

PRACTICAL GUIDANCE

- Enforcement has proprietary technology that identifies suspicious trading faster than ever before
- Focused on trading in advance of FDA announcements and earnings releases
- Issuers should revisit policies and procedures in place to ensure that material non-public information (MNPI) remains confidential
 - Especially in light of Covid-19 and telework environment
- Educate employees about obligations not to share or trade on MNPI

FCPA



WHAT IS THE FCPA?

Anti-Bribery Provision

US persons and businesses are prohibited from offering, promising, authorizing or making corrupt payments to foreign officials to improperly obtain or retain business or obtain an improper business advantage

Books-and-Records Provision

Requires accurate reporting and recording of all transactions

Covers all payments to non-US government officials, regardless of why the payments were made

WHAT IS A “THING OF VALUE”?

A “thing of value” can be any benefit or service that has value to its recipient, including:



Cash



Gift Cards



Gifts



Excessive T&E



Political/
Charitable



Loans



Luxury “Rentals”

WHAT IS ACTING “CORRUPTLY”?

An act is “corrupt” for purposes of the FCPA if it is intended to induce a government official to misuse his or her official position by, for example:

- Wrongfully directing business to a person paying a bribe
- Granting preferential treatment as a result of the bribe, or
- Refraining from taking official action against the person paying the bribe

WHO IS A “GOVERNMENT OFFICIAL”?

- An employee of a government agency
- A legislator
- A member of a political party
- A candidate for political office
- A member of a royal family, with governmental responsibilities
- An official or employee of a state-controlled or state-owned business enterprise (e.g. doctors in government hospitals)
- A consultant acting for or on behalf of a government
- A public international organization

HIGHLIGHTS OF THE UPDATED FCPA GUIDE

Encouraging Corporate Compliance and Cooperation

- The updated FCPA Guide incorporates the DOJ's April 2020 Corporate Enforcement Policy (CEP)
- The CEP emphasizes that corporations enjoy most favorable treatment by demonstrating:
 - Self-disclosure
 - Comprehensive investigations
 - Full and timely cooperation with regulators
 - Willingness to pay disgorgement
 - Compliance program enhancements and remediation
 - Current compliance program is effective

HIGHLIGHTS OF THE UPDATED FCPA GUIDE

Emphasis on Robust Compliance Operations

- The updated FCPA Guide incorporates the DOJ’s Evaluation of Corporate Compliance Program (Guidance)
- The updated FCPA Guide underscores the Guidance’s focuses:
 - Effective compliance programs are “well-constructed, effectively implemented, appropriately resourced, and consistently enforced”
 - When considering a company’s culpability and/or penalty, the DOJ and SEC will focus on the effectiveness of a corporate compliance program both “at the time of the misconduct and at the time of the resolution”
 - Hallmarks of an effective compliance program include:
 - Confidential reporting and internal investigations
 - Periodic testing and review
 - M&A due diligence and integration, and
 - Investigation, analysis, and remediation of any misconduct

HIGHLIGHTS OF THE UPDATED FCPA GUIDE

SEC/DOJ Emboldened by Wins (Continued)

- Conflict Regarding FCPA Applicability to Certain Categories of Foreign Individuals
 - In *United States v. Hoskins*, the Second Circuit rejected the DOJ's argument that the FCPA's anti-bribery provisions applied to individuals even if the individual was not directly covered by the FCPA (i.e., even if the foreign company or individual is not an issuer or domestic concern and did not commit a reasonably foreseeable overt act while in the territory of the United States)
 - The Guide makes clear that the DOJ and SEC take a dim view of this decision by noting its limitations, namely, that it is only binding in the Second Circuit, that another Circuit has taken a different view, and that it does not apply to the FCPA's books-and-records provisions

HIGHLIGHTS OF THE UPDATED FCPA GUIDE

SEC/DOJ Emboldened by Wins (Continued)

- Qualifying as an “Instrumentality” under the FCPA
 - In *United States v. Esquenazi*, the Eleventh Circuit defined “instrumentality” as “an entity controlled by the government of a foreign country that performs a function the controlling government treats as its own”
 - The Eleventh Circuit also created two non-exhaustive lists of factors to determine:
 - whether the government “controls” the entity, and
 - whether the entity performs a function that the government treats as its own
 - The DOJ and SEC encourage companies to consider these factors when evaluating FCPA risk and compliance program designs

KEY TAKEAWAYS

- Continuous Assessment, Review, and Development
 - Is the compliance team conducting on-going assessments of the risks posed?
 - Is the compliance team monitoring the company's own conduct and that of other companies facing similar risks?
 - Is the company updating policies based on data and lessons learned?
 - If misconduct is uncovered, what is done to address the lapse?
 - Is the company continuously managing third-parties throughout the “lifespan of the relationship,” including being able to explain the necessity for the relationship?
 - With M&As, can the company explain the pre-acquisition process? If the pre-acquisition process was not completed, can the company explain why not?
 - With M&As, has the company completed post-acquisition due diligence, including audits?

KEY TAKEAWAYS

- Data-Driven Program
 - Is the compliance team given “continuous access to operational data and information across functions”? And does the compliance team apply lessons learned?
 - Is the company regularly monitoring employee and third-party behavior, including access to policies/procedures, spending habits, and use of hotlines?
 - Is the company analyzing the effects of its trainings, if any?
- Assessing the Right Fit
 - Can the company justify the structure of its compliance program including decisions pertaining to budgeting, staffing, on-going training and development, access to company data, reporting structure, and independence?
 - If the company makes compliance decisions based on the demands of foreign law, can it justify its analysis and explain “how the company has addressed the issue to maintain the integrity and effectiveness of its compliance program while still abiding by foreign law”?

KEY TAKEAWAYS

- Third-Party Risk Management: Emphasis on continued management of third-party risks throughout the life of the third-party relationship
 - Can the company justify why the third party was hired?
 - Can the company identify the risks posed by third party partners?
 - Can the company identify other relationships that third party partners maintain?
 - Does a contract exist to govern the relationship?
 - Is the company monitoring the relationship? If so, how frequently?
 - How does the company address concerns that result from monitoring?
 - Are third party partners required to complete training and sign annual compliance certifications?
 - Are third party partners familiar with and have access to resources, including the company's policies and hotline?

RESOURCES



RESOURCES

- SEC Enforcement Manual and Annual Report
- FCPA Resource Guide
- SEC website
 - Prior settlements
 - Regulatory guidance
 - Spotlight topics
 - Corporation finance

QUESTIONS

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