

# Securities Regulation Law Journal

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# Quarterly Survey of SEC Rulemaking and Major Appellate Decisions

By *Kenneth M. Silverman and Brian Katz\**

**(January 1, 2019 - March 31, 2019)**

*This issue's Survey focuses on the U.S. Securities and Exchange Commission's ("SEC") rulemaking activities and major federal appellate or other decisions relating to the Securities Act of 1933, as amended (the "1933 Act"), the Securities Exchange Act of 1934, as amended (the "1934 Act"), and other federal securities laws from January 1, 2019 through March 31, 2019.*

The SEC finalized just three sets of rules and proposed three new sets of rules in the first quarter of 2019. The SEC's latest rule changes and proposals are largely geared toward streamlining disclosure processes. The finalized rules (a) updated the EDGAR filer manual, (b) adjusted the method by which hearing officers of the Public Company Accounting Oversight Board are appointed and removed from office and (c) modernize and simplify certain disclosure requirements pursuant to Regulation S-K (the SEC's public company disclosure rules, "Reg. S-K"), with the Reg. S-K amendments constituting the SEC's most significant substantive rulemaking during the first quarter of 2019. The SEC also (x) reopened the comment period for the proposed amendment of rules and forms which will assist investors make informed investment decisions regarding variable annuity and variable life insurance contracts, (y) proposed a new rule under the 1933 Act to allow all issuers to solicit interest from qualified institutional buyers and institutional accredited investors prior to a registered public offering and (z) proposed rules to modify the registration, communications, and offering processes for business development companies ("BDCs") and other closed-end investment companies.

Highlights of the Reg. S-K changes and the SEC's proposed new rules are summarized below.

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\*Mr. Silverman and Mr. Katz are members of the New York Bar and Partners at Olshan Frome Wolosky LLP. Counsel Jason Cabico and associates Khasim Lockhart and Brooke Ford assisted the authors.

## *Final Rules*

### **FAST Act Modernization and Simplification of Regulation S-K**

On March 20, 2019, the SEC finalized amendments to 11 items of Reg. S-K, along with parallel amendments to various rules and forms applicable to investment companies and investment advisers, to modernize and simplify the disclosure required by such items, rules and forms. The majority of the amendments to Reg. S-K and related rules and forms previously proposed by the SEC on October 11, 2017, and which we reviewed in our fourth quarter of 2017 SEC rulemaking survey, have been adopted by the SEC. Many of these adopted amendments were effective as of April 2, 2019, and all will be effective as of May 2, 2019.

Items of particular importance to registrants include the following changes:

- Item 102 (Description of Property) has been revised to clarify that a description of physical properties is required only to the extent that the physical properties are material to a registrant, and that such disclosure may be provided on a collective basis, if appropriate. The amendments to Item 102 do not modify instructions applicable specifically to the mining, real estate, and oil and gas industries.
- Item 303 (Management's Discussion and Analysis) has been amended to allow registrants providing financial statements covering three years in a filing to eliminate the management discussion and analysis ("MD&A") relating to the earliest of the three years if that discussion was previously included in any prior filing made by the registrant via the SEC's Electronic Data Gathering, Analysis, and Retrieval system ("EDGAR"). However, the registrant must identify the location in the prior filing where such omitted discussion may be found. The amendments to Item 303 also provide registrants with discretion to use any form of MD&A presentation that would enhance a reader's understanding (and are not limited to using year-to-year comparisons). Finally, with respect to Item 303 amendments, the reference to five-year selected financial data in Instruction 1 to Item 303(a) has been deleted as Item 303(a)(3)(ii) already requires disclosure of known trends and uncertainties.
- Item 405 (Section 16(a) Compliance) was revised to allow registrants, when providing disclosure about their Section 16(a) compliance, to rely on a review of Section 16 reports filed on EDGAR or representations from persons required to file Section 16 reports that no Form 5 was required to be filed by such person, rather than having to rely on reports

furnished directly by such persons to the registrant. The cover page of Form 10-K is also being changed to eliminate the checkbox indicating the registrant has Section 16 filer delinquencies.

- Item 501(b) (Cover Page) has been amended to streamline the information required on the cover page of a prospectus by allowing registrants to (i) state that the offering price will be determined by a particular method or formula that is more fully explained in the prospectus (with a cross reference to such disclosure) and (ii) exclude the portion of the legend relating to state law for offerings that are not prohibited by state blue sky laws. The amendments to 501(b) also require that a registrant disclose the national securities exchange where its securities are listed or, if not listed, the principal U.S. market(s) for such securities, and the corresponding trading symbols of such securities, if any, on the prospectus cover page and the cover page of Forms 8-K, 10-Q, 10-K, 20-F and 40-F (as applicable). The SEC approved additional Inline XBRL tagging obligations in respect of certain cover page amendments. These tagging obligations will be phased in over three years, and large accelerated filers that prepare their financial statements in accordance with U.S. GAAP will be the first group that must comply, beginning with reports for fiscal periods ending on or after June 15, 2019.
- Item 601 (Exhibits) has been amended to reduce and simplify the disclosure of immaterial or sensitive information.
  - New Item 601(a)(5) will permit registrants to omit immaterial schedules and attachments from all exhibits filed under Item 601 (rather than just plans of acquisition, reorganization, arrangement, liquidation or succession, as previously permitted under Item 601(b)(2)).
  - New Item 601(a)(6) will permit registrants to omit, by making appropriate redactions and without submitting a confidential treatment request, personally identifiable information.
  - Similarly, Items 601(b)(2) and 601(b)(10) have been amended to allow registrants to omit, by making appropriate redactions and without submitting a confidential treatment request, confidential information in material contract exhibits that is not material and would be competitively harmful if publicly disclosed.
  - Item 601(b)(10)(i) has been revised to require all registrants to file, as an exhibit to an applicable registration statement or report, those contracts not made in the ordinary course of business that are material to the

registrant and are to be performed in whole or in part at or after the filing of the registration statement or report, and only newly reporting registrants will remain subject to the existing requirement of having to file as exhibits all material contracts which were entered into by it in the two years prior to the applicable filing.

- New Item 601(b)(4)(vi), requires a registrant to file an Item 202 description of all securities it has registered under Section 12 of the 1934 Act as an exhibit to Form 10-K.

Incorporation by reference rules have been amended to provide that a document incorporated by reference must be hyperlinked to the referenced document as filed on EDGAR. In addition, the SEC has amended incorporation by reference rules to prohibit incorporation by reference or cross-referencing, in the financial statements, to information outside of the financial statements.

In many instances, foreign private issuers will also benefit from this modernization and simplification endeavor as the SEC adopted corollary amendments applicable to this category of issuer in these final rules. See SEC Release No. 33-10618 for additional information regarding the SEC's recent amendments to Reg. S-K and analogous rules and forms applicable to investment companies and investment advisers.

### *Proposed Rules*

#### **“Test-the-Waters” Modernization Reform for All Issuers**

On February 19, 2019, the SEC proposed a new rule under the 1933 Act and related amendments to existing rules to permit all issuers, including investment company issuers, to “test-the-waters” when undertaking a registered public offering. The ability to test-the-waters allows an issuer to solicit interest in a proposed registered public offering from qualified institutional buyers and institutional accredited investors before or after the registration statement is filed and before the issuer initiates a full roadshow. Currently, only emerging growth companies (“EGCs”) are able to test-the-waters under the Jumpstart Our Business Startups (JOBS) Act of 2012.

The proposed expansion of testing the waters is intended to encourage more issuers to pursue registered public offerings by allowing all issuers to assess the interest of large investors in an offering before expending the effort required to file a registration statement with the SEC and engage in a full roadshow. The new rule would benefit larger companies with over \$1.07 billion in an-

nual revenues and other issuers that do not currently qualify as EGCs. The new rule continues efforts by the SEC to make the public offering process less burdensome for issuers. The SEC has requested that all comments on these proposed rule changes be submitted by April 29, 2019. See SEC Release No. 33-10607 for additional information.

### **BDC & Registered Closed-End Fund Registration to Be Streamlined**

On March 20, 2019, the SEC proposed modifying the registration, communications, and offering processes for BDCs and other closed-end investment companies (together, “Affected Funds”) under the 1933 Act. BDCs are closed-end investment companies that were established pursuant to the Investment Company Act of 1940, as amended (the “1940 Act”), to facilitate investments by non-accredited investors in small and mid-sized companies. BDCs are not required to register under the 1940 Act but they may elect to register under the 1940 Act in order to receive certain tax benefits.

Under the SEC’s proposed new rules, the definition of “well-known seasoned issuer” would be modified so as to include Affected Funds, thereby letting Affected Funds make automatic shelf registrations, rely on more flexible disclosure requirements, use free writing prospectuses to avoid gun-jumping restrictions and benefit from other simplified registration process rules. In addition, the proposed rule changes would (i) allow certain Affected Funds to use a short-form shelf registration statement, (ii) allow Affected Funds to satisfy their final prospectus delivery requirements by filing the prospectus with the SEC, (iii) allow Affected Funds to make additional communications (including certain factual business information, forward-looking information, free writing prospectuses, and broker-dealer research reports) during the registration process and (iv) revise disclosure requirements for Affected Funds to better match the proposed rule amendments and the nature of the business of such Affected Funds. The proposed amendments would impose new reporting requirements, including annual report disclosure of key information by Affected Funds, reporting of material developments under new Form 8-K items to be specifically adopted for Affected Funds, and structured data disclosures to allow investors to better analyze fund data. The SEC has requested that all comments on these proposed rule changes be submitted by June 10, 2019. See SEC Release No. 33-10619 for additional information.

## **Second Circuit Grants Defendant's Motion to Dismiss, Finding Misstatements Regarding Corporate Compliance Not Materially Misleading to Prove Scienter**

On March 5, 2019, the United States Court of Appeals for the Second Circuit affirmed the United States District Court of Connecticut's dismissal of a Putative Class Action suit brought against multi-national health services organization, Cigna Corporation ("Cigna"), by its shareholders ("Plaintiffs"), holding that Cigna's statements regarding the importance of regulatory compliance despite its ongoing committing of regulatory violations, were not materially misleading and thus did not constitute fraud under Section 10(b) and Rule 10b-5 thereunder.

On February 4, 2016, Plaintiffs filed a Putative Class Action complaint on behalf of all individuals who had acquired Cigna securities between February 27, 2014 and January 21, 2016, alleging that Cigna defrauded the class by making materially misleading statements in affirming the importance of regulatory compliance by issuing public statements concerning its commitment to regulatory compliance. First, in its 2013 10-K, Cigna stated that it "established policies and procedures to comply with applicable requirements" and it "expect[s] to continue to allocate significant resources" to its compliance efforts. In that 10-K, however, Cigna stated that its business was "subject to . . . numerous and complex regulations and requirements that are frequently modified and subject to administrative discretion." Second, in December 2014, Cigna published a pamphlet titled "Code of Ethics and Principles of Conduct" which stated "it's so important for every employee . . . to handle, maintain, and report on [Cigna's financial] information in compliance with all laws and regulations." Third, in its 2014 10-K, Cigna stated that it "expect[s] to continue to allocate significant sources" to compliance. At the times these statements were released, however, Cigna experienced several compliance infractions. Between April 2014 and December 2015, Cigna received more than 75 notices for compliance violations from the Centers for Medicare and Medicaid Services ("CMS"). On January 21, 2016, Cigna received a letter from CMS indicating that Cigna significantly failed to adhere to its requirements and that it would thereby be subject to sanctions. The following day Cigna issued an 8-K regarding its receipt of the CMS letter. Consequently, Cigna's stock price fell substantially.

The Court determined that Cigna's statements were not materially misleading because they were tentative and generic and therefore would not cause a reasonable investor to rely upon them. The Court viewed the statements in Cigna's Code of Ethics

as a textbook example of puffery, reasoning that they were too general to cause a reasonable investor to rely upon them. Further, the Court reasoned that the statements in the 2013 and 2014 10-Ks were not descriptive enough to amount to actionable assurances. The Court also reasoned that the framing of Cigna's statements, usually presented in conjunction with statements acknowledging the complexity and numerosity of applicable regulations, suggests caution, rather than confidence, regarding Cigna's ability to be fully compliant. Based on these findings, the Court concluded that Plaintiffs failed to allege that the statements were materially misleading.

*Singh v. Cigna Corporation*, 918 F.3d 57, Fed. Sec. L. Rep. (CCH) P 100368 (2d Cir. 2019).

### **United States Supreme Court Finds Individual Can Be Liable for Disseminating Known Misstatements, Regardless of Whether He “Makes” Misleading Content**

On March 27, 2019, the United States Supreme Court affirmed the District of Columbia Circuit's decision, holding that an individual may be liable for disseminating information he knows to be false in violation of Section 10(b) and Rule 10b-5(a) and (c), even if he did not “make” the statements, as defined in Rule 10b-5(b).

In 2013, the SEC instituted proceedings against Petitioner for disseminating false information to prospective investors. Petitioner was the director of investment banking at a registered broker-dealer in Staten Island, New York. During the summer of 2009, Waste2Energy Holdings, Inc. (“Waste2Energy”) hired Petitioner's firm to sell debt interest in the company to potential investors. In June 2009, Waste2Energy had publicly disclosed that its total assets were worth about \$14 million. By October 2009, the company's total assets were reduced to \$400,000, due to a write off the company's intangible assets. Despite knowledge of the company's significant drop in assets, Petitioner sent two emails to prospective investors praising Waste2Energy and noting that the company had \$10 million in “confirmed assets.” Petitioner claimed that his superior supplied the content of the emails and he merely disseminated that information, thus he did not “make” the false statements in violation of Rule 10b-5(b). The SEC determined that Petitioner had violated Rule 10b-5(a) and (c), fined him \$15,000, and instituted a lifetime bar on working in the securities industry. Petitioner appealed the SEC's decision and the District of Columbia Circuit affirmed. Thereafter, Petitioner filed a petition for certiorari to the United States Supreme Court, arguing he could not be held liable under subsec-



tion (b) of Rule 10b-5 because he did not “make” the false statement, pursuant to the Supreme Court’s interpretation of the Rule in *Janus Capital Group, Inc. v. First Derivative Traders*, 564 U.S. 135, 131 S. Ct. 2296, 180 L. Ed. 2d 166, Fed. Sec. L. Rep. (CCH) P 96327 (2011). Petitioner further argued that it did not matter if he violated subsections (a) and/or (c) of Rule 10b-5 because they were mutually exclusive.

The Supreme Court rejected Petitioner’s argument that applying Rules 10b-5(a) and (c) to conduct such as Petitioner’s would render the Court’s decision in *Janus* meaningless. In *Janus*, the Supreme Court held that the “maker” of the statement, pursuant to Rule 10b-5(b), is the person or entity with ultimate authority over that statement. Thus, an investment adviser who merely participated in drafting a false statement “made” by another would not be held liable in a private action under Rule 10b-5(b). However, the Court noted that *Janus* does not opine on the Rule’s application to the dissemination of false or misleading information. Thus here, when Petitioner sent emails he understood to contain material untruths, he was disseminating false information and thus violated sections (a) and (c) of Rule 10b-5 because he employed a scheme to defraud and engaged in an act that operated as a fraud or deceit. Further, the Supreme Court rejected Petitioner’s argument that because he was not liable under subsection (b), the SEC was barred from charging Petitioner with violations under (a) and (c). The Supreme Court noted that it and the SEC have long recognized the overlap between the subsections of the Rule and other provisions of the securities laws, holding that each subsection does not govern a separate type of conduct and simply because he was not the “maker” of the fraudulent statement did not mean his behavior fell outside the scope of the securities laws. Thus, the Supreme Court found that while Petitioner may not have “made” the statement, he disseminated false information to potential investors with the intent to defraud.

*Lorenzo v. Securities and Exchange Commission*, 139 S. Ct. 1094 (2019).