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# 2020 year in review: Congress and the Supreme Court

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## Introduction

The incoming Biden Administration's financial regulatory legislative agenda will likely present a dramatic contrast to that of the outgoing Trump Administration. But to what extent will Congress and the Supreme Court produce different results for the Biden agenda than was the case the last time Democrats held the Whitehouse during the Obama Administration? For example, will Republicans in congress frustrate major securities legislation that could address climate change disclosures by public companies? Will Democrats, and perhaps a small number of Republicans, risk the steep price paid by some lawmakers who supported passage of the Dodd-Frank Act if asked again to back a major financial reform package? Democrats will have a majority in the House for the 117th Congress but with a narrower margin than they had in the 116th Congress. The Senate majority in the 117th Congress remains in doubt pending twin runoff elections in Georgia in January; the resulting majority, for which ever party wins, will be razor thin. Also, to what extent will the federal courts, including the Supreme Court, now shaped by the addition of many conservative judges and justices during the Trump Administration, potentially take a much harder look at doctrines that historically have ensured that courts defer to regulatory agency judgments, such as under the *Chevron*, *Auer*, and *Skidmore* doctrines?

All of these questions will come into sharper focus once the Senate majority has been settled and the now six-member conservative majority on the Supreme Court begins to issue opinions during the October 2020 term. Meanwhile, *Securities Regulation Daily* takes a look back at key developments in the 116th Congress and the Supreme Court's October 2019 term with an eye to what can be expected in the 117th Congress and the Supreme Court's October 2020 term. To be sure, the past year or so produced mixed results on a variety of securities law topics ranging from a small number of bipartisan bills being passed by both the House and the Senate but, in some instances, with somewhat less certain prospects for a presidential signature in the lame duck session. Results for securities regulators were likewise mixed at the Supreme Court. For example, the justices have in a series of opinions mostly upheld the SEC's authority to seek, and for federal courts to order, disgorgement, but Congress continues to pursue legislation to solidify the SEC's disgorgement authorities. These and many more issues are discussed in this year's review of Congress and the Supreme Court.

## Congress

The COVID-19 pandemic upended much of the normal securities- and commodities-related committee work in Congress, especially markups, although many hearings continued to be held remotely and the full House adopted rules to allow remote proxy voting on bills. It remains unclear if 2021 will be any different, at least early in the year. Nevertheless, the 116th Congress completed some important business with respect to securities law. For one, Congress sent a disgorgement bill to the president's desk for signature along with a bill authorizing the SEC to delist foreign companies operating in jurisdictions that bar PCAOB inspections of audit work papers. Congress also enacted the Coronavirus Aid, Relief, and Economic Security (CARES) Act to provide economic relief to individuals and businesses affected by the COVID-19 pandemic; these provisions included limits on executive compensation for executives at businesses receiving COVID-19 relief. This section also will profile the key personalities likely to impact securities and commodities legislation in the 117th Congress.

Finally, this section will take a look ahead at what could be one of the Biden Administration's signature issues beyond controlling the COVID-19 pandemic and restarting the economy—a potential all-of-government approach to climate change with possible impacts for ESG disclosures under securities regulations. The look ahead on ESG disclosures will review some general ESG disclosure trends, existing SEC regulations, and legislation introduced in the 116th Congress that suggests how the SEC may be asked to address future ESG disclosures.

**COVID-19 and Congress.** The second session of the 116th Congress began with the normalcy of almost any other session but with the added expectation that members were unlikely to make progress on many issues given the upcoming general election in November 2020. But that would all change in March when much of the U.S. shut down during the first surge of COVD-19 cases. Congressional committees would eventually resume hearings by remote means, but the House Financial Services Committee (FSC), for example, would not hold a traditional legislative markup after February 2020. The Senate, however, continued to confirm nominees to federal agencies, including SEC Commissioners Hester Peirce (for a second term) and newcomer Caroline Crenshaw, both of whom SEC Chairman Jay Clayton would welcome to the Commission in August 2020.

The full House, however, would continue voting both in person, albeit with members called to the floor in groups for only so long as it took to cast their votes. Without the Senate's luxury, at least in some instances, to conduct business via unanimous consent, the House had adopted rules (H. Res. 965) in May 2020 to allow members to vote remotely by proxy in order to lessen the risk that members could transmit the virus that causes COVID-19. The proxy rules were approved by a vote of 217-189, with all Republicans plus three Democrats and the chamber's only Independent, former Republican Justin Amash (I-Mich), voting against the resolution.

Republican members sued Speaker Nancy Pelosi (D-Cal) asserting that the proxy voting rules violated numerous constitutional tenets, as summarized by the D.C. District Court, including "the Quorum Requirement, the Yeas and Nays Requirement, the nondelegation doctrine, and the

 

general structure of the United States Constitution, which they maintain require actual physical presence to do the business of the House." Democrats demurred and the D.C. District court dismissed the case without reaching the merits on the ground that the Speech or Debate Clause immunized Democrats from suit. Republicans appealed and the case was argued before the D.C. Circuit in early November 2020.

The one brief moment of significant bipartisanship would occur in late March 2020 when Congress enacted the Coronavirus Aid, Relief, and Economic Security (CARES) Act (H.R. 748). The CARES Act contained targeted and time-limited aid provisions for sectors of the U.S. economy, such as the aviation sector. These provisions also contained limits on executive compensation, although the Treasury Secretary was granted authority to waive these limits. The House would revisit the subject matter and in mid-May 2020 passed the $3 trillion Health and Economic Recovery Omnibus Emergency Solutions (HEROES) Act (H.R. 6800) mostly along party lines by a vote of 208-199. Fourteen Democrats voted against the bill and one Republican voted for the bill, suggesting possible room for further compromise on a next-stage COVID-19 relief bill with a better chance to become law, depending on whether the Senate would ultimately agree to a narrower relief package. As of publication, the House, Senate, and the Trump Administration have not agreed to further COVID-19 aid legislation. Likewise, Congress and the Trump Administration also have not agreed to FY 2021 appropriations legislation despite the expiration of current government funding on December 11, 2020, although it is possible Congress will pass one or more short-term continuing resolutions to keep the government open pending a final appropriations deal.

Lastly, members of Congress have themselves become embroiled in allegations that they may have profited from their inside knowledge of the COVID-19 pandemic gained in nonpublic government briefings on the virus. Initial allegations arose regarding Sen. Dianne Feinstein (D-Cal), Sen. Kelly Loeffler (R-Ga) (currently seeking reelection in one of Georgia's two January 2021 U.S. Senate runoff elections), Sen. James Inhofe (R-Okla) and Sen. Richard Burr (D-NC). The allegations against Sen. Burr, however, have perhaps drawn the most public speculation and even resulted, briefly, in a private securities fraud suit being filed against the senator asserting that he violated Exchange Act Sections 10(b) and 20A and Rule 10b-5 as well as the Stop Trading on Congressional Knowledge (STOCK) Act of 2012. The plaintiff later voluntarily dismissed the suit ostensibly to avoid getting in the way of potential federal investigations of Sen. Burr. Media reports indicate that federal investigators have been closed regarding Sens. Feinstein, Loeffler, and Inhofe but not Sen. Burr. In mid-May 2020, Sen. Burr announced that he would step down as Chairman of the U.S. Senate Select Committee on Intelligence for the duration of any investigations into his stock trading. The committee, under Sen. Burr's leadership, had been handling one of the Congressional investigations into Russian interference in the 2016 election. The legislative reaction to allegations about members' stock trading resulted in the swift introduction of the Ban Conflicted Trading Act (S. 1393; H.R. 6401), sponsored by Sen. Jeff Merkley (D-Or) and Raja Krishnamoorthi (D-Ill), which would further ban certain stock trades by members of Congress and by congressional employees.

**Congressional leadership.** The leadership of the FSC and the House Agriculture Committee in the 117th Congress will be examples of congressional diversity because both committees will

 

be led by African Americans. Representative Maxine Waters (D-Cal) will remain chairwoman of the House FSC following her approval by the House Democratic Caucus. Waters said in a press release that she intends to broadly align congressional financial policy with the Biden Administration's goals.

To this end, the House FSC will likely pursue an agenda focused on consumer and investor protection, diversity and inclusion, COVID-19 economic relief, and climate change disclosures. This agenda would largely be a continuation of legislative goals Waters pursued during the 116th Congress but perhaps with more vigor in light of what Waters characterized just days after media outlets projected that former Vice President Joe Biden would win the electoral college vote and become the next president as Biden's "Mandate to Protect Consumers and End Trump's Wall Street First Agenda."

"It is clear that Americans want a financial and economic system that works for them and not against them. I was inspired by the words of President-elect Biden on how he wants to unify the country," said Waters. "As ever, I stand ready to work with Members on both sides of the aisle and the incoming Biden Administration on reforming our financial system so that consumers and investors have the protections they need." Waters added: "We are emerging from the dark days of the Trump Administration into the dawn of a new progressive America, where pro-consumer and pro-investor policies will always be first on the agenda."

The House Republican Conference likewise reelected Rep. Patrick McHenry (R-NC) to be ranking member of the House FSC. McHenry said in a press release that Republicans will continue to pursue "pro-growth policies" and COVID-19 relief while offering "a clear alternative to Democrats' government-first agenda." A related announcement of ranking members in the 117th Congress issued by House Republican Leader Kevin McCarthy (R-Cal) said of McHenry: "His leadership will allow Financial Services Committee Republicans to provide effective oversight in the upcoming Congress, as Democrats attempt to use the financial system to push their progressive priorities."

Perhaps the most significant House leadership changes will occur on the House Agriculture Committee where current Chairman Collin Peterson (D-Minn) will be departing Congress after losing his reelection bid. Similarly, the Agriculture Committee's current Ranking Member, K. Michael Conaway (R-Texas), is retiring from Congress. Both men can mutually lament their unsuccessful efforts to enact a long overdue CFTC reauthorization bill when they respectively held the committee's chairmanship, Peterson during the 116th Congress (H.R. 4895; H.R. 6197) (H.R. 4895 was reported by the Agriculture Committee by voice vote and placed on the House calendar in November 2019 but never received a vote by the full House; H.R. 6197 was never acted upon after introduction), and Conaway during the 115th Congress (H.R. 238) (passed House in January 2017 by a vote of 239-182).

Peterson and Conaway recently complimented each other on their public service on the occasion of House passage of the United States Grain Standards Reauthorization Act of 2020 (it passed the Senate and the House by voice vote), a reminder of the core work of the Agriculture Committee despite the pull of CFTC swaps and derivatives regulation that often dominates the committee's work on CFTC oversight.

 

Conaway said of Peterson: "I don't think there has been anyone more dedicated and more steadfast as a supporter for rural America and production agriculture than Chairman Peterson." Peterson said of Conaway: "With this bill, we got just about all of our work done. We have the CFTC reauthorization we didn't get done, but everything else is off the plate. So that is good." Peterson added: "We made good progress. We will, both of us, ride off into the sunset, I think, feeling that we have done a decent job." (See, Congressional Record, December 2, 2020, at H6031).

Peterson's replacement will be Rep. David Scott (D-Ga), a long-time member of the Agriculture Committee since 2003 and who also will be the first African American to serve as the committee's chairman. Most recently, Scott was chairman of the Agriculture Committee's Subcommittee on Commodity Exchanges, Energy, and Credit.

"I owe this historic selection as the first African American Chairman of the House Agriculture Committee to a diverse coalition of members from across our nation. And I will use this critical opportunity to represent the values of our entire caucus and advance our priorities for trade, disaster aid, climate change, sustainable agriculture, SNAP, crop insurance, small family farms, specialty crops, and rural broadband," said Scott via press release. "The fault lines dividing our rural and urban communities are running deep, and climate change is now threatening our nation's food supply. As Chairman, I will lead the fight to rise up and meet these challenges."

Peterson praised Scott for being the first African American to lead the Agriculture Committee and said "[h]e will make a great Chairman, and I'm proud to pass the reins to him." According to a statement by Conaway, "David has a long history of serving this nation, both in the Georgia State Legislature and in Congress. He has proven himself to be a champion for rural America."

Conaway will be replaced as ranking member by Glenn "GT" Thompson (R-Pa). "The challenges ahead of us are considerable, but we will continue to put farm families first and ensure our country has the most safe and affordable food supply chain on the planet," said Thompson upon being elected to the role by the Republican Steering Committee. Thompson was most recently the ranking member of the Agriculture Committee's Subcommittee on General Farm Commodities and Risk Management.

Conaway had this to say about Thompson: "GT has served as my deputy on the House Agriculture Committee for the past six years. He was instrumental in crafting the 2018 Farm Bill, and I know he'll continue to bring his strong work ethic and steadfast commitment to America's farmers and ranchers to this new role." Peterson said of Thompson: "I have had the pleasure of working with GT on dairy and conservation issues, and I know he and David Scott will make a great team to lead the Committee in the 117th Congress."

The Senate picture, however, is a bit less clear. First, there is a question about whether Democrats or Republicans will have a Senate majority in the 117th Congress due to the pending twin runoff elections in January in Georgia. Second, although current Senate Banking Committee Chairman Mike Crapo (R-Idaho) would likely not be term limited under GOP rules, there have been numerous

 

media reports that he could hand over the Banking Committee chair to Sen. Patrick Toomey (R-PA) in order to take the Finance Committee chair. Senator Sherrod Brown (D-Ohio) is currently the ranking member of the Banking Committee.

With respect to the Senate Agriculture Committee, Chairman Pat Roberts (R-KS) is retiring after 40 years in Congress and having served on the Agriculture Committees in both the House and the Senate. Numerous media outlets have reported that his replacement, if Republicans retain their Senate majority, could be Sen. John Boozman (R-Ark). Senator Debbie Stabenow (D-Mich) is the current ranking member of the Senate Agriculture Committee. Stabenow has congratulated Scott and Thompson on their new leadership roles on the House Agriculture Committee. Stabenow also has praised President-elect Biden's selection of former Senator and Secretary of State John Kerry to be Special Presidential Envoy for Climate. "I look forward to working with him [Kerry] to further the bipartisan work that the Senate Agriculture, Nutrition, and Forestry Committee is doing to address this urgent crisis. By harnessing our farms and forests we can protect our climate and grow our economy," said Stabenow.

**The passing of Sen. Sarbanes.** Former Senator Paul Sarbanes (D-Md), the co-author of the Sarbanes-Oxley Act (SOX), has died at the age of 87. Sarbanes along with Rep. Michael Oxley (R-Ohio), who died in 2016, pressed to reform the auditing profession after the Enron and WorldCom scandals. The Supreme Court upheld the constitutionality of the agency at the heart of SOX, the Public Company Accounting Oversight Board (PCAOB), albeit by stripping away dual tenure protections for PCAOB board members that had been built into SOX. Principles announced by the majority in that case would later factor prominently in cases challenging the constitutionality of the SEC's administrative law judges and the single-director structure of the Consumer Financial Protection Bureau. In other cases, the Supreme Court has both expanded and limited SOX's reach. The Supreme Court may elect to hear yet another case interpreting a SOX provision, this time involving an amendment to Title 18 of the federal laws to allow criminal prosecutions of insider trading potentially without identical requirements to similar prosecutions under Title 15 of the federal laws dealing specifically with securities regulation (See, *U.S. v. Blaszczak* and the related petition for certiorari). Despite the several court challenges, Sen. Sarbanes' and Rep. Oxley's vison for SOX has largely stood the test of time since its enactment in July 2002.

**Bills awaiting presidential signature.** As of publication, two bills related to securities law were awaiting presidential signature. One authorizes the SEC to seek, and a federal court to order, disgorgement in enforcement matters. The second bill addresses the SEC's authority to delist foreign companies whose operations are located in jurisdictions that do not allow inspections by the PCAOB. Further legislation on COVID-19 relief and FY 2021 appropriations remain in flux as discussions between lawmakers and the outgoing Trump Administration continue. President Trump has even threatened to veto the William M. (Mac) Thornberry National Defense Authorization Act for Fiscal Year 2021 (NDAA), which contains the SEC disgorgement provision, because of a provision in the NDAA regarding the renaming of military bases named after Confederate officials and the absence of a provision that would limit the ability of social media companies to address false or inaccurate posts.

 

***—SEC disgorgement.*** The NDAA (H.R. 6395) contains the bulk of the Senate version of legislation aimed at securing the SEC's right to seek, and the authority of federal courts to order, disgorgement in securities enforcement matters. However, the compromise version assigns different limitations periods for disgorgement depending on whether the matter involves scienter (10 years) or does not involve scienter (5 years). The compromise version also dropped a Senate proposal to authorize the SEC to seek restitution. The NDAA conference report passed the House by a vote of 335-78 and the Senate by a vote of 84-13, sufficient numbers in both chambers to override the threatened presidential veto, unless members were to later change their vote on the question of whether to override such veto. The Supreme Court in *Kokesh* and *Liu* had largely resolved the question of whether the SEC may seek, and a federal court may order, disgorgement. That said, however, a few issues like the general, five year federal limitations period contained in 28 U.S.C. §2462 still can affect SEC investigations by forcing the agency to develop evidence at a faster pace that may not always match the complexity of the investigation, especially in Foreign Corrupt Practices Act (FCPA) cases. Bills introduced in the House and Senate would have legislatively confirmed the disgorgement authorities possessed by the SEC and federal courts. However, the House bill would have extended the five year limitations period to 14 years, while the Senate bill would have granted the SEC the additional option of seeking restitution. The House passed its disgorgement bill (H.R. 4344), sponsored by Rep. Ben McAdams (D-Utah), by a vote of 314-95, while the Senate bill (S. 799), sponsored by Sen. Mark Warner (D-Va), had been awaiting further action.

***—Delisting foreign companies.*** The House passed the Holding Foreign Companies Accountable Act (S. 945), sponsored by Sen. John Kennedy (R-La) and Sen. Chris Van Hollen (D-Md), by voice vote. The bill provides for the delisting from U.S. exchanges of foreign companies whose auditors are located in jurisdictions that do not permit PCAOB inspections. The bill is phrased mostly in neutral language that does not identify a particular foreign jurisdiction, although a disclosure requirement for foreign companies filing Forms 10-K and 20-F specifically calls for information about the Chinese Communist Party. The Senate had passed the bill in May 2020 by unanimous consent. The Senate version of the bill now goes to the president's desk for possible signature.

**Major financial legislation?** The financial impacts of the COVID-19 pandemic have re-exposed long problematic aspects of the U.S. economy such as housing finance pressures on residential borrowers, although the larger macro economy has stayed afloat due the massive fiscal and monetary stimulus provided by Congress and the Fed in early 2020. Nevertheless, many financial issues remain potentially attractive legislative targets for a Democratic administration that will be led by a President-elect who played a significant role in the Obama Administration's efforts to revive the economy after the Great Recession. But the question remains whether the close majorities in Congress (the Senate is as yet unresolved due to pending Georgia runoff elections) will be sufficient for Democrats to enact major financial legislation. If Democrats, likely spurred by the progressive wing of the party, pursue a package of financial legislation, it could focus on a possible reorganization of federal financial regulators and/or corporate responsibility.

But the incoming Biden Administration, for example, may face legislative roadblocks to a broader reorganization of federal financial regulators unless Democrats are able to achieve control of the

 

Senate. Even then, a narrow Senate majority could make it necessary to scale back larger plans in order to ensure passage of financial legislation that is more incremental in scope and, thus, would not risk losing the votes of Democrats from more conservative states. For example, a financial regulator revamp and consolidation on the scale proposed by Wolters Kluwer outside expert Joel Seligman in his new book "Misalignment: The New Financial Order and the Failure of Financial Regulation" (published by Wolters Kluwer Incorporated) might have to await a more favorable legislative environment after the next midterm elections or even a second Biden Administration. Such a large-scale reform may be difficult to sell when many current economic problems have arisen because of the COVID-19 pandemic rather than from specific financial system defects, although authors like Seligman contend that such systemic financial defects still exist and must be addressed.

Similarly, legislation proposed by Sen. Elizabeth Warren (D-Mass) that focuses more narrowly on public corporations rather than the larger swath of federal financial regulatory agencies will likely have to await a more favorable legislative environment. The senator's Accountable Capitalism Act would, among other things, require large companies to obtain a federal public benefit company-style corporate charter, require that employees nominate 2/5 (40 percent) of a company's directors, limit executive compensation by imposing a holding period on sales of company stock, and require approval of any corporate political donations by a company's directors and shareholders. It is an open question whether the Biden Administration would actively pursue such legislation, although the progressive wing of the Democratic party will likely continue to call for action on corporate responsibility. However, the Accountable Capitalism Act, even if never enacted, may still have an aspirational impact on some companies and, in that sense, it may also help to push organizations like the Business Round Table to make good on recent pledges to emphasize companies' wider collection of stakeholders beyond their shareholders. The House companion bill is sponsored by Rep. Ben Ray Lujan (D-NM) (H.R. 6056).

**Bills with bipartisan support.** The Democrat-controlled House during the 116th Congress passed a number of bills on securities topics with overwhelming bipartisan support. Will these bills reappear in the next Congress? A crucial test for these bills in the 117th Congress, especially if Republicans retain control of the Senate, will be whether such bills can even get a vote in the Senate. One group of bills addressing SEC disgorgement already found an outlet in compromise form in the NDAA discussed above, but two other bills focused on corporate insiders are the ones to watch going forward:

***—8-K trading gap.*** The 8-K Trading Gap Act of 2019 (H.R. 4335; S. 2488) would bar executives from trading company shares during the window before a Form 8-K is due to be filed with, or furnished to, the SEC. The House passed the 8-K Trading Gap Act by a vote of 384-7 in January 2020. Representative Carolyn Maloney (D-NY), sponsor of the House version, cited a study titled The 8-K Trading Gap, by Alma Cohen, Robert J. Jackson, Jr., and Joshua Mitts (September 7, 2015), for the deleterious effects of insider trading before major corporate news is announced. Jackson is a former SEC commissioner and a possible candidate for SEC chair under the Biden Administration. Senator Chris Van Hollen (D-Md) sponsored the Senate version of the legislation. One year earlier, the House overwhelmingly passed related legislation that would curb abuses of Rule 10b5-1 plans.

 

—***Insider trading.*** Insider trading remains a largely judicially created offense predicated on Exchange Act Section 10(b) and Rule 10b-5, although a criminal statute added by the Sarbanes-Oxley Act (18 U.S.C. 1348) could finds its way to the Supreme Court (more on the petition for certiorari below). Congress has tried and failed on several prior occasions to enact a definition of insider trading. In the years since the Second Circuit's *Newman* opinion, and despite the Supreme Court's clarifications and reaffirmations of the *Dirks* personal benefit test in *Salman*, congress continues to attempt a legislative definition of insider trading. The latest effort (H.R. 2534), sponsored by Rep. Jim Himes (D-Conn), passed the House by a vote of 410-13. Given the several insider trading investigations involving members of Congress, related legislation would impose further curbs on members, who are already subject to the STOCK Act (see above discussion of COVID-19 and Congress).

**A preview of ESG bills in the 117th Congress.** ESG disclosure may get a second look by the incoming Biden Administration's SEC and CFTC. The Biden transition team has already flagged climate change as a key regulatory objective. Both the SEC and the CFTC took small, modest steps in the direction of ESG disclosures during the last four years, with the SEC revising the environmental disclosures required under Regulation S-K and adding disclosures on human capital issues in that same rulemaking, while a CFTC advisory subcommittee issued a significant report on climate change.

The leadership of congressional committees with oversight responsibilities for the SEC and the CFTC have already said publicly that ESG and, in particular, climate change, will be a major focus of their oversight of these agencies in the 117th Congress. House FSC Chair Waters has stated that "climate change," "disclosing corporate climate risks," and "addressing climate risks to financial stability" will be major issues for her committee. Moreover, Representative Joyce Beatty (D-Ohio), the founding chair of the House FSC's Subcommittee on Diversity and Inclusion, also has been elected chair of the Congressional Black Caucus (CBC) in the 117th Congress. Upon her election to CBC chair, Beatty said a trio of "pandemics" must be addressed on behalf of Blacks: "COVID-19, economic turmoil, and social injustice." Beatty also said government must address "racial wealth equity and sustainability" and the need to "clean up our environment." Incoming House Agriculture Chair Scott has identified "climate change" and "sustainable agriculture" as key issues.

Legislation in the 117th Congress could target the Department of Labor's recent efforts to curb ESG investing. Representatives Andy Levin (D-Mich), Suzan DelBene (D-Wash), and Brendan Boyle (D-Pa), for example, have asked the Department of Labor to roll back its planned regulation of socially responsible investing. According to the DOL's ESG regulation: "The fundamental principle is that an ERISA fiduciary's evaluation of plan investments must be focused solely on economic considerations that have a material effect on the risk and return of an investment based on appropriate investment horizons, consistent with the plan's funding policy and investment policy objectives. The corollary principle is that ERISA fiduciaries must never sacrifice investment returns, take on additional investment risk, or pay higher fees to promote non-pecuniary benefits or goals." (Financial Factors in Selecting Plan Investments, Release No. RIN 1210–AB95, October 30, 2020, 85 F.R. 72846, November 13, 2020) (effective January 12, 2021)).

 

Several bills in the 116th Congress would address a range of generalized ESG issues, while other bills, discussed below, would target the individual components of the ESG or EESG framework. One generally applicable bill, the ESG Disclosure Simplification Act (H.R. 4329), sponsored by Rep. Juan Vargas (D-Cal), would require the SEC to define "ESG metrics" and then mandate public company disclosures of their ESG metrics. ESG metrics disclosures would be deemed de facto material. The bill also would require the SEC to create the Sustainable Finance Advisory Committee. The Accountable Capitalism Act, sponsored by Sen. Elizabeth Warren and Rep. Ben Ray Lujan (D-NM), would require large companies to obtain a federal charter with organizational requirements that track the public benefit company model (see the discussions above regarding major financial legislation and below regarding employees and governance).

The following mini-primer focuses on legislation that would mandate that the SEC adopt ESG disclosures on a variety of topics. Moreover, the mini-primer employs former Delaware Supreme Court Chief Justice Leo Strine's "EESG" framework, which stands for "employees" (the added "E"), "environmental," "social," and "governance." This framework was chosen because the bills introduced in the 116th Congress generally fit the "EESG" formula, although bills addressing "employees" and "social" issues can be somewhat difficult to categorize because of the overlap between issues affecting employees and society at large.

***—Employees.*** In August 2020, the SEC adopted revisions to Regulation S-K that, among other things, mandate disclosure, to the extent material to understanding a company's business as a whole, information about human capital resources, including the measures or objectives the company uses to manage the business. The revision was a significant development but one that many lawmakers believe may not go far enough given the number of bills that have been introduced regarding disclosures about employees. Recent bills cover a wide range of employee-oriented topics:

- ***Accountable Capitalism Act***—The bill would require large companies to allow employees to elect 40 percent of a company's board.

- ***Reward Work Act*** (S. 915; S. 3540; H.R. 3355), sponsored by Sen. Tammy Baldwin (D-Wis) and Jesus "Chuy" Garcia (D-Ill). The bill would require that a company allow its employees to elect one-third (33 percent) of the company's directors. A later version of the bill would impose the same requirement on companies receiving COVID-19 aid and making a certain amount of share buybacks within a five year period.

- ***Outsourcing Accountability Act of 2019*** (S. 1843; H.R. 3624), sponsored by Sen. Gary Peters (D-Mich) and Rep. Cynthia Axne (D-Iowa). The bill would add Exchange Act disclosure regarding public company outsourcing of jobs (excluding emerging growth companies). The House version passed the House on October 18, 2019 by a vote of 226-184.

 

- ***Greater Accountability in Pay Act of 2019*** (H.R. 4242), sponsored by Rep. Nydia Velasquez (D-NY). The bill would add Exchange Act pay ratio-style disclosure for pay increases of executives as compared to the median of all employees. The bill was reported by the House FSC on September 20, 2019 by a vote of 32-21.

- ***H.R. 6360***, sponsored by Rep. Alexandria Ocasio-Cortez (D-NY). The bill would require extensive workforce disclosures for public companies.

- ***Take Responsibility for Workers and Families Act*** (H.R. 6379), sponsored by Rep. Nita Lowey (D-NY). Recipients of COVID-19 aid would have to adhere to human capital and other workforce disclosure provisions.

- ***Protections and Transparency in the Workplace Act*** (H.R. 8458), sponsored by Rep. Ted Lieu (D-Cal). The bill addresses a wide range of discriminatory behaviors (including race, sex, and LGBTQ discrimination). The bill would require annual and quarterly disclosure regarding: (1) claims; (2) claims under investigation; (3) number of settlements; (4) number of court judgments; (5) aggregate amount of payments (including third-parties and insurance); (6) outcomes of adjudicated cases—presumably "adjudicated" means courts and administrative cases; (7) repeat settlements; (8) remedial efforts (e.g., employee training and prevention); and (9) the average time to resolve claims.

- ***Workforce Investment Disclosure Act of 2020*** (H.R. 5930; S. 3361), sponsored by Sen. Mark Warner (D-Va) and Rep. Cynthia Axne (D-Iowa). The bill would require a range of workforce disclosures similar to other bills. The bill was reported on party lines by the House FSC on February 28, 2020 by a vote of 33-25.

***—Environmental.*** Environmental disclosure can likewise address a wide range of topics, including climate change. Any future SEC disclosure requirements would likely be keyed, at least in part, to overarching federal policy as set by the incoming Biden Administration.

Public company disclosure of climate change risks is a main feature of many of the several environmental-themed bills introduced in the 116th Congress. Sen. Warren, for example, introduced her own bill on the topic while also calling on the SEC to adopt regulations mandating climate change disclosures. BlackRock Chairman & CEO, Larry Fink, has said that "[d]isclosure should be a means to achieving a more sustainable and inclusive capitalism" in a letter urging CEOs to do more regarding climate change and sustainability. The Investment Company Institute in December 2020 called on public companies to follow recommendations made by the Task Force on Climate-Related Financial Disclosures (TCFD) and the Sustainability Accounting Standards Board (SASB).

The debate within the SEC in recent years on climate change disclosure—and ESG more generally—has centered on principles-based versus prescriptive rules. This debate recently was brought into open during a colloquy between Commissioners Allison Herren Lee and Hester Peirce during

 

the an open meeting to adopt revisions to Regulation S-K.[1] Also at the SEC, the Asset Management Advisory Committee's ESG Subcommittee recently issued a draft recommendation to the full AMAC that the SEC not alter existing ESG-related requirements that companies make material disclosures, but the subcommittee did recommend that the SEC adopt mandatory standards to achieve "consistent, comparable, complete, and meaningful disclosure." A key concern for the subcommittee is the potential for misuse of ESG in labeling financial products. Moreover, the SEC's Investor Advisory Committee's Investor-as-Owner Subcommittee in May 2020 had recommended that the SEC revise its reporting requirements to add "material, decision-useful, ESG factors."

Existing SEC disclosure requirements for climate change and other environmental issues centers on a small number of provisions in Regulation S-K. Item 101(c)(2)(i), for example, requires disclosure of "the material effects that compliance with government regulations, including environmental

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1 SEC commissioners recently have spoken extensively on ESG topics, especially climate change. The following references focus on climate change, but they often can be applied to the entire spectrum of ESG. The speakers raise a panoply of issues that any ESG legislation likely will have to address. See, e.g.: Jay Clayton, Remarks at Meeting of the Investor Advisory Committee, November 7, 2019 (posing questions to the IAC regarding "decision-useful" (aka 'material') information"); Allison Herren Lee, Statement at Inaugural Meeting of the Asset Management Advisory Committee, January 14, 2020 (SEC climate guidance aging and U.S. risks falling behind other countries); Allison Herren Lee, "Modernizing" Regulation S-K: Ignoring the Elephant in the Room, January 30, 2020 ("MD&A is uniquely suited to disclosures related to climate risk"); Jay Clayton, Statement on Proposed Amendments to Modernize and Enhance Financial Disclosures; Other Ongoing Disclosure Modernization Initiatives; Impact of the Coronavirus; Environmental and Climate-Related Disclosure, January 30, 2020 (materiality should remain key to disclosures and "standard setters should… stay within the bounds of their regulatory mandate"); Hester Peirce, Statement on Proposed Amendments to Modernize and Enhance Financial Disclosures, January 30, 2020 ("Securities regulators of this generation must not grow weak-kneed in defending the concept of materiality, which continues to play a central role in ensuring the vibrancy of our capital markets. We ought not step outside our lane and take on the role of environmental regulator or social engineer."); Jay Clayton, Remarks at Meeting of the Asset Management Advisory Committee, May 27, 2020 ("I believe I have made it clear that, while I believe that in many cases one or more 'E' issues, 'S' issues, or 'G' issues are material to an investment decision, I have not seen circumstances where combining an analysis of E, S and G together, across a broad range of companies, for example with a 'rating' or 'score,' particularly a single rating or score, would facilitate meaningful investment analysis that was not significantly over-inclusive and imprecise."); Elad Roisman, Keynote Speech at the Society for Corporate Governance National Conference, July 7, 2020 (reiterating his support for the SEC's existing principles-based, materiality-driven approach to disclosure but calling for more ESG disclosure from asset managers); Allison Herren Lee, Regulation S-K and ESG Disclosures: An Unsustainable Silence, August 26, 2020 ("This year's upheavals have driven home that ESG risks, like those associated with diversity and climate change, are strong predictors for resilience and for maximizing risk-adjusted returns" (footnotes omitted)); Caroline Crenshaw, Statement on the "Modernization" of Regulation S-K Items 101, 103, and 105, August 26, 2020 ("The question of whether climate change and human capital are material concerns of investors is no longer academic."); Hester Peirce, Statement at Open Meeting on Modernization of Regulation S-K 101, 103, and 105, August 26, 2020 (praising "incremental reforms" such as for "environmental proceedings" involving the government for retaining "flexibility" for registrants); Hester Peirce, Lucy's Human: Remarks at Virtual Roundtable on The Role of Asset Management in ESG Investing Hosted By Harvard Law School and the Program on International Financial Systems, September 17, 2020 (questioning whether the SEC should allow reliance on a single ESG standard setter); Allison Herren Lee, Playing the Long Game: The Intersection of Climate Change Risk and Financial Regulation, November 5, 2020 ("The SEC should work with market participants toward a disclosure regime specifically tailored to ensure that financial institutions produce standardized, comparable, and reliable disclosure of their exposure to climate risks, including not just direct, but also indirect, greenhouse gas emissions associated with the financing they provide…"); Allison Herren Lee and Caroline Crenshaw, Joint Statement on Amendments to Regulation S-K: Management's Discussion and Analysis, Selected Financial Data, and Supplementary Financial Information, November 19, 2020 (expressing disappointment over revised MD&A disclosure but stating; "We have an opportunity going forward to address climate, human capital, and other ESG risks, in a comprehensive fashion with new rulemaking specific to these topics."); Elad Roisman, Statement at the Meeting of the Asset Management Advisory Committee, December 1, 2020 (posing seven questions to the SEC's AMAC regarding ESG investing and SEC regulation).

 

regulations, may have upon the capital expenditures, earnings and competitive position of the registrant and its subsidiaries, including the estimated capital expenditures for environmental control facilities for the current fiscal year and any other material subsequent period." A similar provision contained in Item 101(h)(4)(xi) provides for scaled disclosures by smaller reporting companies. Items 103, 105, and 303 of Regulation S-K also may require climate change or other environmental disclosures regarding legal proceedings, risk factors, and Management Discussion and Analysis, respectively (See, Modernization of Regulation S–K Items 101, 103, and 105, Release No. 33–10825, August 26, 2020, 85 F.R. 63726, October 8, 2020 (effective November 9, 2020)).

Commission guidance issued in 2010 also provides recommendations for climate change disclosures. Specifically, in addition to required Regulation S-K disclosures, a company may disclose information about: (1) the impact of legislation and regulations; (2) international accords; (3) indirect consequences of regulations or business trends (e.g. reputation risk); and (4) the physical impacts of climate change (Commission Guidance Regarding Disclosure Related to Climate Change, Release No. 33-9106, February 2, 2010, 75 F.R. 6290, February 8, 2010; SEC Codification of Financial Reporting Policies 501.15 (largely restating the Commission guidance).

Two recent developments, however, could limit the ability of shareholders to propose changes to public companies' policies on ESG more generally, and climate change in particular, despite growing emphasis placed by shareholders on these topics. The first development consists of the SEC's adoption of regulations for proxy advisers (Exemptions From the Proxy Rules for Proxy Voting Advice, Release No. 34–89372, July 22, 2020, 85 F.R. 55082, September 3, 2020). The second development involves the SEC's adoption of a new tiered structure for determining whether shareholders can submit proposals at annual meetings. The new structure favors wealthier investors over smaller investors, who must hold their shares for a longer period of time than is required of larger shareholders. The new rules also increase the resubmission thresholds for shareholder proposals (Procedural Requirements and Resubmission Thresholds Under Exchange Act Rule 14a–8, Release No. 34–89964, September 23, 2020, 85 F.R. 70240, November 4, 2020).

Other guidance applies to shareholder proposals and plainEnglish requirements. (See: Shareholder Proposals: Staff Legal Bulletin No. 14K (CF), October 16, 2019; Shareholder Proposals: Staff Legal Bulletin No. 14J (CF), October 23, 2018; Shareholder Proposals: Staff Legal Bulletin No. 14C (CF), June 28, 2005; Staff Legal Bulletin No. 7A, June 7, 1999 (sample risk factor language includes example of REIT acquisition of properties with environmental risks or the need to clean up properties that have environmental damage); Compliance and Disclosure Interpretation (C&DI)—Question 301.01 (shareholder proposal description that would not satisfy Rule 14a-4(a)(3)).

With some regulatory background in mind, it is clear that legislation introduced in the 116th Congress generally tracks the Commission's 2010 guidance but typically with more prescriptive disclosure requirements. Bills include the following:

- ***ESG Disclosure Simplification Act of 2019*** (H.R. 4329), sponsored by Rep. Juan Vargas (D-Cal)—The bill would require the SEC to amend Regulation S-X to define ESG metrics and mandate that public companies make related disclosures about links between ESG metrics and

 

long-term impact on its business and about the process the company used to determine that impact. ESG metrics disclosures would be deemed de facto material. The bill was reported on party lines by the House FSC September 20, 2019 by a vote of 31-22.

- ***Climate Change Financial Risk Act of 2019*** (S. 2903; H.R. 5194), sponsored by Sen. Brian Schatz (D-Hawaii) and Rep. Sean Casten (D-Ill). The bill would require the Fed to impose climate change rules on certain banks; the SEC and the CFTC would be involved only as FSOC members regarding a proposed subcommittee.

- ***Climate Risk Disclosure Act of 2019*** (S. 2075; H.R. 3623), sponsored by Sen. Elizabeth Warren (D-Mass) and Rep. Sean Casten (D-Ill). The bill addresses: (1) physical risks; (2) transition risks; (3) corporate governance processes and structures to identify, assess, and manage climate-related risks; (4) specific actions that the covered issuer is taking to mitigate identified risks; (5) the resilience of any strategy for addressing climate risks when differing climate scenarios are taken into consideration; and (6) how climate risk is incorporated into the overall risk management strategy of the covered issuer. The bill was reported on party lines by the House FSC July 16, 2019 by a vote of 34-25.

- ***Systemic Risk Mitigation Act of 2020*** (H.R. 6501), sponsored by Jesus "Chuy" Garcia (D-Ill). the bill would create an FSOC climate change subcommittee. The FSOC was created by the Dodd-Frank Act to monitor systemic financial risks and its members are the heads of the federal banking regulators and the SEC and the CFTC. The proposed subcommittee would include the Fed, Treasury, OCC, FDIC, SEC, CFTC, and other agencies the FSOC deems appropriate. The subcommittee would submit an annual report to Congress, in consultation with the Office of Financial Research, regarding the risks posed by climate change to the efficiency, competitiveness, and stability of the United States financial system as a whole.

- ***H.R. 6360***, sponsored by Rep. Alexandria Ocasio-Cortez (D-NY). The bill would require public companies to make climate disclosures consistent with recommendations made by the Task Force on Climate-Related Financial Disclosures of the Financial Stability Board as reported in June 2017.

- ***Take Responsibility for Workers and Families Act*** (H.R. 6379), sponsored by Rep. Nita Lowey (D-NY). The bill would require recipients of COVID-19 aid to make climate disclosures consistent with recommendations of the Task Force on Climate-related Financial Disclosures of the Financial Stability Board as reported in June 2017.

- ***H. Res. 109 (Green New Deal)***, sponsored by Rep. Alexandria Ocasio-Cortez (D-NY). The resolution recognizes the challenge of climate change and seeks economic security against harm resulting from climate change.

- ***S.J. Res. S8 (Green New Deal)***. The resolution was called for a vote by Sen. Mitch McConnell (R-Ky) but failed to obtain cloture by vote of 0-57. All but three Democrats voted present, while Sen. Doug Jones (D-Ala) (who lost reelection in 2020), Sen. Manchin (D-WVa), Sen. Kirsten

 

Sinema (D-Ariz), and Sen. Angus King (I-Me) voted with Republicans. Sen. Edward Markey (D-Mass had sponsored a similar resolution (S.J. Res. 59)).

—***Social.*** The "social" component of ESG or EESG also covers a range of issues. SEC Commissioner Allison Herron Lee recently spoke on why diversity is important and in doing so quoted the adage "what gets measured gets managed" (Allison Herron Lee, Diversity Matters, Disclosure Works, and the SEC Can Do More: Remarks at the Council of Institutional Investors Fall 2020 Conference, September 22, 2020). The adage is often employed across the ESG/EESG spectrum and many of the legislative proposals on diversity are about empowering individuals to publicly assert their identities so that diversity can be better measured. The following discussion briefly reviews some of the SEC's attempts to encourage diversity followed by summaries of proposed bills on diversity and other social topics:

- ***Diversity and inclusion***—The SEC has issued Compliance and Disclosure Interpretations (C&DIs) regarding Items 401 and 407 of Regulation S-K (Questions 116.11 and 133.13, February 6, 2019) allowing companies to disclose board members' and board nominees' diversity characteristics (e.g., race, gender, ethnicity, religion, nationality, disability, sexual orientation, or cultural background), but only if the member or nominee self-identifies as having such characteristic and then consents to the disclosure. Several bills in Congress would address the issue of board diversity and related diversity and inclusion matters:

  - ***Improving Corporate Governance Through Diversity Act*** (S. 360; H.R. 5084), sponsored by Sen. Bob Menendez (D-NJ) and Rep. Gregory Meeks (D-NY). The bill would require an issuer to disclose in a proxy statement and in any information statement related to the election of directors filed with the Commission three things: (1) data on the racial, ethnic, and gender composition of the issuer's board, board nominees, and executive officers; (2) the veteran status of any board member, board nominee, or executive officer; and (3) whether, as of the date the issuer makes the required disclosures, the issuer's board or a board committee has adopted any policy, plan, or strategy to promote racial, ethnic, and gender diversity among the issuer's board members, board nominees, and executive officers. Data called for by items 1 and 2 would be based on voluntary self-identification. The bill passed the House in November 2019 by a vote of 281-135.

  - ***Diversity in Corporate Leadership Act*** (S. 3367; H.R. 3279), sponsored by Sen. Catherine Cortez Masto (D-Nev) and Rep. Carolyn Maloney (D-NY). The bill would require companies to disclosure the gender, racial, and ethnic composition of their board members and board nominees. The House FSC favorably reported an amended version of the bill by a vote of 52-6 in July 2019.

  - ***H.R. 8566***, sponsored by Rep. Gregory Meeks (D-NY). The bill would require the Fed and the SEC to study racial gaps in stock ownership.

  - ***Diverse Asset Managers Act***. A discussion draft proposed by Rep. Joyce Beatty (D-Ohio), Chairwoman of the House FSC's Subcommittee on Diversity and Inclusion, would require the

 

Fed and the SEC, and companies registering securities with the SEC, to consider at least one diverse asset manager when contracting for management services.

– ***H.R. 4257***, sponsored by Rep. David Scott (D-Ga). The bill would fix a Dodd-Frank Act oversight by formally establishing an Office of Minority and Women Inclusion (OMWI) at the CFTC which has, in the absence of a legislative requirement, established an OMWI. The bill also directs the CFTC to create an internship program within the OMWI. A similar provision appears in proposed CFTC reauthorization legislation. "Through this scholarship program, some of our brightest and most promising young scholars will gain valuable experience that will continue to serve them throughout their careers," said Rep. Scott via press release.

- ***Supply chain risks and human rights abuses***—Legislation also would require disclosure by companies of their operations in countries where human rights abuses have been alleged to be occurring:

  – ***Uyghur Forced Labor Disclosure Act*** (H.R. 6270), sponsored by Rep. Jennifer Wexton (D-Va). The bill would impact public companies' business in the Xinjiang Uyghur Autonomous Region (XUAR) in China. Specifically, it would require public companies to disclose in their annual reports or proxy statements: (1) whether the company engages with an entity that imports certain manufactured goods or imports manufactured goods that contain materials that originated or are sourced in the XUAR (this provision would appear to require disclosure for goods, such as electronics, food products, textiles, shoes, and teas, that would be excepted from the SEC disclosure provision in a related sanctions bill); (2) whether goods and materials subject to the disclosure requirement originated in forced labor camps; and (3) a description of the commercial activity, gross revenues, and net profits regarding the goods or materials, and whether the company intends to continue importing the goods or materials. The bill passed the House on September 30, 2020 by a vote of 253-163.

  – ***Uyghur Forced Labor Prevention Act*** (S. 3471; H.R. 6210), sponsored by Sen. Marco Rubio (R-Fla) and Rep. James McGovern (D-Mass). The bill would prohibit the importation by U.S. companies of certain goods made in the XUAR, create an enforcement regime, require the State Department to make certain findings about the XUAR and to create a strategy regarding the XUAR, and implement a sanctions regime. The Uyghur Forced Labor Prevention Act also contains a securities disclosure provision that resembles the existing Iran sanctions disclosure provision contained in Exchange Act Section 13(r). The bill passed the House on September 2, 2020 by a vote of 406-3.

  – ***S. Res. 760***, sponsored by Sen. John Cornyn (R-Texas). The resolution states that the Chinese government's treatment of Uyghurs in the XUAR constitutes genocide and calls on China to respect its human rights commitments.

  – ***H.R. 6375***, sponsored by Rep. Nydia Velazquez (D-NY). The bill would require public companies to disclose supply chain disruption risks, such as geographic concentrations, shipping risks, and risks from armed conflict (See also the related bills H.R. 6321 and H.R. 6379).

 

- ***LGBTQ status***—The Data Inclusion Act (H.R. 3509; H.R. 3509), sponsored by Sen. Tammy Baldwin (D-Wis) and Rep. Raul Grijalva (D-Ariz). The bill would apply to agencies' collection of data on LGBTQ status when conducting surveys; the bill would impact SEC and CFTC via the Administrative Procedure Act's definition of "agency."

—***Governance.*** With respect to governance matters, federal legislation can become a bit tricky because of federalism concerns and the general delegation of the regulation of the internal affairs of companies to state laws, despite the overlap between federal and state laws, for example, regarding the proxy process. Nevertheless, federal legislation introduced in the 116th Congress would address a range of issues, including a federal corporate charter, stock buybacks, executive compensation, and political donations.

- ***Stock buy backs and executive compensation***—Exchange Act Rule 10b-18 allows stock buybacks subject to requirements that take such transactions outside of the general securities law ban on manipulation. Over the course of the last two Congresses, three approaches to curbing corporate buybacks have emerged: (1) Sen. Tammy Baldwin (D-Wis) would ban buybacks altogether (S. 915; H.R. 3355); (2) Senators Bernie Sanders (I-Vt) and Rep. Ro Khanna (D-Cal) would ban public company buybacks unless workers receive increased pay and benefits; the bill was largely targeted at Walmart Inc., which has since asserted that it has made at least some changes to worker rewards and paid time off (S. 3640; H.R. 7145, 115th Congress); and (3) Senator Warren's and Rep. Lujan's Accountable Capitalism Act would require a public benefit company-style charter for large public companies and would require company executives to have skin in the game by imposing a 3-year holding period on selling company shares after a company stock buyback (S. 3215; H.R. 6056).

- ***Stop Wall Street Looting Act*** (S. 2155; H.R. 3848), sponsored by Sen. Warren and Rep. Mark Pocan (D-Wis). The bill covers many topics, including curbing share buybacks and closing the carried interest loophole.

- ***Ending Too Big to Jail Act*** (S. 1005), sponsored by Sen. Warren. The bill would address criminal accountability by financial institution executives.

- ***Accountable Capitalism Act*** (S. 3215; H.R. 6056), sponsored by Sen. Warren and Rep Lujan. The bill also would bar corporate political donations unless approved by 75 percent of a company's directors and shareholders.

- ***Transparency in Corporate Political Spending Act*** (H.R. 1176), sponsored by Rep. Andy Levin (D-Mich). The bill would repeal the policy rider contained in recent appropriations legislation banning the SEC from adopting regulations addressing corporate political donations (See Public Law No. 115-245, Division C, Section 101(4), incorporating by reference Public Law No. 115-141, Section 631).

- ***Shareholders United Act of 2019*** (H.R. 936), sponsored by Rep. Jamie Raskin (D-Md). The title of the bill is a play on words invoking the Supreme Court's landmark opinion *Citizens United* that would allow corporate political donations only if a company has in place a procedure to assess the preferences of its shareholders.

 

## Supreme Court Developments

The latter half of 2020 proved to be eventful for the Supreme Court. As the summer progressed, the COVID-19 pandemic and telephonic conferences became a fact of life. Then, shortly before the OT2020 Term kicked off, Justice Ruth Bader Ginsburg died, followed in rapid succession by the nomination and confirmation of Justice Amy Coney Barrett. As of this writing, the nation is still digesting the effect of a rancorous presidential election, one in which the Court has already taken part and may still play a significant role. Despite these challenges, the Court has soldiered on, and 2020 saw some significant developments in the securities realm.

### Decisions from OT2019

***Liu* outlines disgorgement's borders.** The major securities-related issue facing the court in the 2019 term was disgorgement, with a total of four petitions asking the court to resolve an issue left open in *Kokesh v. SEC*: whether the SEC can obtain disgorgement from a federal court as an equitable remedy. In 2017, the Court held in *Kokesh* that SEC disgorgement awards are penalties for purposes of the applicable general federal limitations period, but deferred the question of "whether courts possess authority to order disgorgement in SEC enforcement proceedings or on whether courts have properly applied disgorgement principles in this context."

That case, however, was limited to the statute-of-limitations context, and before long, challenges arose as to the Commission's ability to seek disgorgement as an equitable remedy. Chief among these was *Liu v. SEC*, in which two defendants in a civil enforcement action challenged a district court's order that they disgorge almost $27 million raised from investors, with no deduction for their business expenses. The Ninth Circuit, in an unpublished decision, upheld the order based on *Kokesh* and longstanding circuit precedent, stating that the proper amount of disgorgement is the entire amount raised minus any money paid back to investors.

The petition for certiorari argued that Congress authorized the Commission to seek only injunctions, civil monetary penalties, and equitable relief. As a penalty, then, disgorgement falls outside the scope of equitable relief and thus lacks any statutory authority. Unlike penalties, the petitioners continued, equitable remedies aim to restore the status quo rather than punish the wrongdoer. In this case, the disgorgement left the petitioners nearly $16 million in debt relative to their position before the alleged fraud, and there was no indication that any disgorged funds would be returned to the victims. At oral argument, the justices seemed reticent to dispense with the disgorgement remedy entirely, but asked a number of pointed questions about how disgorgement should be calculated and whether it should be conditioned on the return of recovered funds to investors

On June 22, 2020, the Court held in *Liu* that a disgorgement award that does not exceed a wrongdoer's net profits and is awarded for victims is permissible equitable relief. Writing for the Court, Justice Sotomayor said that equity practices have long authorized stripping wrongdoers of ill-gotten gains and that Congress incorporated these longstanding equitable principles into Exchange Act Section 21(d)(5), thus prohibiting the Commission from seeking an equitable remedy in excess of the net profits from the wrongdoing. *Liu* accordingly restricts the scope of what can be recovered to the individual wrongdoer's net profits from the unlawful activity.

 

Having defined the limits of disgorgement, the court vacated the Ninth Circuit's judgment and remanded the case for proceedings consistent with the opinion. At issue in this case was the question of whether any sort of disgorgement may be ordered, and any narrower issues were not decided. The final section of the opinion, however, offers principles to guide the lower court's assessment on remand. Here, Justice Sotomayor criticized the imposition of joint and several liability, as well as the SEC's practice of depositing collected funds with the Treasury, stating that the SEC's obligation is to award relief "for the benefit of investors;" these issues were left for the lower courts to evaluate. Significantly, the opinion states that legitimate expenses must be deducted before ordering disgorgement, and the lower courts should examine, "consistent with equitable principles" whether expenses have "a value independent of fueling a fraudulent scheme."

**Disgorgement post-*Liu*: net profits and benefits to be hashed out.** As a result of the *Liu* decision, two petitions raising essentially the same issue were granted, vacated, and remanded for treatment consistent with that holding. *Team Resources Inc. v. SEC* (19-978) and *De Maison v. SEC* (19-7714) also focused on whether the SEC may obtain disgorgement from a federal court as an equitable remedy. In both cases, the parties agreed that the petitions should be held and then disposed as appropriate in light of *Liu*, and the cases went back to the Fifth and Second Circuits, respectively.

To date, the lower courts have adhered to the net profits principle, but have yet to elaborate upon when disgorgement is "for the benefit of investors." In *Janus Spectrum*, decided shortly after *Liu*, the Ninth Circuit, in an unpublished opinion, determined that the disgorgement awarded by the district court did not exceed Janus Spectrum's net profits. The district court, however, did not address whether the disgorgement was "for 'the benefit of investors'" or whether its award of joint and several liability was consistent with equitable principles. The panel accordingly remanded for the district court to make these determinations in the first instance and consistent with *Liu's* guidelines. More recently, in *Rinfret v. SEC* (SDNY), the court applied *Liu* to find that ordering disgorgement of $8 million in net profits was consistent with equitable principles, since it was fraudulently obtained from investors; the SEC also said that it would use almost the entirety of the funds to compensate those investors.

In addition, a lower court in the Ninth Circuit has amended a final judgment ordering disgorgement. In *SEC v. Catledge*, the District of Nevada ordered a final judgment in late 2019 finding that a defendant, who had solicited investments in a fraudulent scheme, was liable for nearly $57 million in disgorgement. Reconsidering post-*Liu*, the court said that the central issue was "the Supreme Court's delineation of net profits being the only proceeds subject to disgorgement." Here, the SEC identified $163.8 million taken from investors. Out of this amount, the court, based on *Liu*, did not consider as net profits a total of $14.8 million that was properly invested or returned to investors and funds; the court also disregarded $90.1 million that Catledge never controlled. The court eventually whittled down the amount to $6.3 million, which was then deemed satisfied by restitution ordered in a parallel criminal proceeding.

Finally, Congress has introduced legislation in the wake of *Kokesh* and *Liu* concerning disgorgement in securities enforcement matters. These efforts are addressed elsewhere in this review.

 

**CFPB constitutionality and ERISA fiduciary duty.** The Court issued two other opinions in the 2019 term bearing on matters that are also of interest to the securities community. In *Seila Law LLC v. CFPB* (19-7) the Court ruled that the CFPB's independent single-director leadership structure violates the constitutional separation of powers. The Court found that the CFPB's leadership by a single individual removable only for inefficiency, neglect, or malfeasance impedes upon the President's removal powers under Article II of the U.S. Constitution, but the director's removal protection was severable from the Dodd-Frank Act provisions bearing on the CFPB's structure and duties. And, in *Retirement Plans Committee of IBM v. Jander* (18-165), a *per curiam* opinion vacated and remanded a petition asking to clarify *Fifth Third v. Dudenhoeffer's* "more harm than good" pleading standard. According to the Court, the merits briefing was occupied by two arguments that were not addressed by the lower courts, and since these arguments had not been raised before the Second Circuit, the Court declined to address them. On remand, the Second Circuit reinstated its earlier ruling and declined to entertain any new arguments; a subsequent petition to the Court was denied certiorari without comment.

### OT2020: A judicial aspirant lacks standing to challenge how Delaware picks judges

The first case of interest to be decided in OT2020 relates to corporate governance and involves a challenge to how Delaware selects its judges. On December 10, 2020, the Court held in *Carney v. Adams*, that a would-be judge failed to show that he was "able and ready" to apply for a judicial vacancy and, thus, lacked standing to bring a constitutional challenge against Delaware's party-membership and bare majority requirements for its judiciary.

For over a century, Delaware's state constitution set out a system by which the benches of the state courts must be balanced between the major political parties. For example, three seats on the Delaware Supreme Court must go to one party and two to the other; other courts may similarly have a "bare majority" of its members belonging to one party. The system also effectively excludes all candidates who are not members of the Republican or Democratic parties from the Supreme Court, Superior Court, or Chancery Court; in these courts, those members not in the majority are required to be of the other "major party."

The case was brought by a Delaware resident, James Adams, who wished to be considered for a judicial position open to Republicans, but, being an Independent, believed that applying would be futile. So, Adams challenged the provision, arguing under Court precedent that a provision limiting a judicial candidate's freedom to associate (or not) with the political party of his or her choice is unconstitutional. The district court granted summary judgment in favor of Adams, and this was affirmed by the Third Circuit. The appellate court invalidated both the bare-majority and major-party provisions, concluding that they work in tandem to achieve political balance and could not be severed.

Delaware's petition for certiorari asked if the First Amendment invalidated the "bare majority" provision and, secondly, whether the major-party provision was severable. In the petition, Governor Carney argued first that the Supreme Court should take the case to resolve a split between the Third Circuit and the Sixth, Seventh, and Second Circuits regarding the application of a line of Supreme Court decisions on policymaking and government jobs. These decisions, *Elrod v. Burns* (1976)

 

and *Branti v. Finkel* (1980) prohibit the government from making party affiliation a condition of employment if that employee is not in a policymaking position. The Third Circuit concluded that this "policymaking exception" did not apply because the "judicial position is not a political role tied to the will of the Governor and his political preferences." Both the Sixth and Seventh Circuits have concluded that judges make policy, and the Second Circuit affirmed a similar holding in an unpublished summary order. A number of amici wrote in favor of granting certiorari because they want the Court to clarify this policymaking exception.

Certiorari was granted in December 2019, and in addition to the questions presented by the petition, the Court asked the parties to brief and argue whether Adams had demonstrated Article III standing. The Third Circuit found that Adams had standing to challenge the provisions dealing with the selection process for the Delaware Supreme Court, Superior Court, and Court of Chancery, but lacked standing with respect to the Family Court and Court of Common Pleas; he could have applied to judgeships on the latter courts, which are not subject to the major-party restriction. None of the certiorari-stage briefing had addressed standing at any length.

In his merits brief, Governor Carney emphasized Adams's lack of a constitutionally recognizable injury. Adams, the brief said, failed to show that he had any concrete desire to become a judge, pointing to the fact that in the past, multiple openings had existed for Democrats (to which party Adams belonged at the time) but Adams showed no interest in pursuing them. The brief asserted further that Adams's harm was "self-inflicted" because he became an Independent mere days before suing. Moreover, as an Independent, there is no possibility that Adams could create an unlawful supermajority on any Delaware court with only a bare majority requirement. In response, Adams asserted that he is categorically excluded from applying for a judgeship because he is not a Republican or Democrat and that he would apply but for this discrimination; he should not be required to choose between seeking a judgeship and violating his political conscience by re-joining a major party.

Oral argument in the case was originally set for March 2020, but was postponed in response to the then-new pandemic. On the first day of the Court's October 2020 term, eight justices (Justice Ginsburg having died in September) heard arguments by telephone. The threshold question of whether Adams had Article III standing consumed much of the time as the justices wrestled with how concrete Adam's plans to apply for a position must be to establish an injury. As to the merits of the case, the justices focused on Delaware's interest in political balance and whether the bare-majority requirement was sufficient to balance partisanship and promote an independent judiciary.

The Court's interest in the standing issue perhaps served as a portent of its eventual holding. In an 8-0 decision by Justice Breyer, the Court reversed the Third Circuit's decision with respect to standing, vacated the judgment, and remanded with instructions to dismiss the case. As Justice Breyer put it: "This case begins and ends with standing."

Standing requires a concrete and imminent "injury in fact" that must be more than an abstract, generalized harm. Unfortunately for Adams, the Court concluded that he suffered only a "generalized grievance" to which all citizens of Delaware are subject. To show a "personal and individual injury," Adams must show that he is "able and ready" to apply to be a judge in the reasonably foreseeable

 

future. The Court concluded that he did not make this showing, pointing out, for example that he did not apply for vacancies for which he was eligible as a then-Democrat.

This "highly fact-specific" case hinged on three considerations that convinced the Court that Adams was not "able and ready" to apply for a judgeship. First, Adams's statement that he "would apply" stood alone without an actual past injury, a timeframe for applying, any prior applications, research into or preparation for likely openings, or any other supporting evidence. The context also suggested an abstract, generalized grievance—and a desire to vindicate his view of the law— rather than an actual desire to become a judge. Finally, if the Court were to hold that only a few words of general intent sufficed to show an injury in fact, it would weaken the longstanding doctrine against the Court issuing advisory opinions at the request of an individual who, without a concrete injury, simply believes that the government is not following the law. The holding in this case, then, follows from a straightforward application of precedent to the record: Adams failed to show that he was "able and ready" to apply and consequently lacked a personal, concrete, and imminent injury.

In a brief concurrence, Justice Sotomayor observed that the questions in this case are likely to be raised again and highlighted two important considerations. First, there are material differences between the major party and bare majority requirements in that the major party requirements are far more rare and arguably impose a greater burden on associational rights. This distinction then raises the possibility that the provisions are severable, she wrote, observing that this is a "sensitive issue of state constitutional law" that may be best handled by certifying it to the relevant state's highest court. This is especially so where, as in this case, "invalidating a state constitutional provision would affect the structure of one of the state's three major branches of government." Justice Barrett took no part in the consideration or decision of the case.

### Granted Petitions

On December 11, 2020, the Court granted certiorari for a petition arguing that defendants should be permitted to rebut the *Basic* presumption of reliance by pointing to evidence that may also be relevant to the question of materiality. The petitioners in *Goldman Sachs Group, Inc. v. Arkansas Teacher Retirement System* urge the court to reverse a decision upholding class certification in a suit alleging that the firm falsely represented its ability to remain conflict-free despite participating in a conflicted collateralized debt obligation (CDO). The petition asks whether a defendant in a securities class action may rebut the presumption of classwide reliance recognized in *Basic Inc. v. Levinson* by pointing to the generic nature of the alleged misstatements in showing that the statements had no impact on the price of the security, even though that evidence is also relevant to the substantive element of materiality.

The complaint alleged that Goldman Sachs misrepresented its commitment to putting the interests of its clients first while it knew that it was riddled with undisclosed conflicts of interest. The shareholders focused in particular upon a 2007 CDO transaction in subprime mortgages in which Goldman had allowed a hedge fund to actively select risky mortgages as part of the portfolio while the hedge fund bet against that same portfolio via short sales. Goldman later admitted to failing to disclose the hedge fund's role and later paid a then-record high penalty to settle with the SEC.

 

The district court certified the class, concluding that the *Basic* presumption applied because there was no real dispute that the market for Goldman's stock was efficient and because the plaintiffs' demonstrated an obvious link between the release of information revealing the misstatements to the market and the subsequent drop in stock price. On appeal, however, the Second Circuit reversed, deciding that the district court had not properly applied the preponderance-of-the-evidence standard under the Supreme Court's 2014 opinion in *Halliburton Co. v. Erica P. John Fund, Inc.* (*Halliburton II*). On remand, the district court again certified the class, and this time a divided panel of the Second Circuit affirmed. The court rejected Goldman Sachs's effort to rebut the *Basic* presumption by pointing to the generic and aspirational nature of the alleged misstatements in an attempt show that the statements had no impact on the price of the security.

The petition argues that the Second Circuit's decision guarantees certification in almost any class action premised, as here, on the "inflation maintenance" theory. Under that theory, which has never been recognized by the Court, plaintiffs seeking class certification need only identify a drop in a company's stock price and then assert that the alleged misconduct not only artificially inflated the price, but also kept it from decreasing. The circuit decision conflicts with *Halliburton II* by preventing a defendant from relying on the nature of the alleged misstatements to show the absence of an impact on the price of a security when seeking to rebut the *Basic* presumption at the class-certification stage. According to the petitioners, the Second Circuit's characterization of an inquiry into the nature of the alleged misstatements as merely a "means for smuggling materiality into Rule 23" directly conflicts with *Halliburton II*'s mandate that evidence of price impact should not be "artificially limit[ed]" simply because that proof may also be highly relevant at the merits stage.

In their brief in opposition, the respondents maintain that there is no circuit conflict and that the Second Circuit's decision was correct. No court, the respondents say, has ever accepted what Goldman argues: that a defendant can defeat class certification by showing that its challenged statements are immaterial, so long as it labels that argument a "price impact," rather than a "materiality," defense. The logic of *Halliburton II* precludes defendants from attempting to disprove price impact by arguing that the statements were immaterial. No matter what, the brief says in conclusion, Goldman would lose under its own argument because its statements were material, despite its assertions to the contrary—the shareholders would not have been indifferent to the fact that Goldman was advising clients to buy into CDOs that were built to fail.

In its reply brief, Goldman accuses the respondents of recasting the petition's main argument in terms of *Amgen*, that is, as a request for resolution at the class certification stage of the merits issue of materiality. The brief insists, however, that the Second Circuit's decision conflicts with *Halliburton II* by barring a defendant from pointing to the generic nature of the statements on which a plaintiff's claim is based as part of showing no price impact, even though that evidence may also be relevant to materiality. To this point, the brief cites the dissent by Judge Sullivan in the Second Circuit case and a Seventh Circuit opinion (for which then-Judge Barrett was on the panel) explaining that a court may not refuse to consider price-impact evidence simply because it may also have implications for merits issues.

 

The petitioners assert that this case is "the most important securities case to come before the Court" since *Halliburton II*. Indeed, with a conservative majority now on the Court, it is possible, at least plausible, that this case may prove to be a vehicle for allowing more of the merits of a securities class action to be addressed at the class certification stage. Several amici filed in support of the petitioners, including SIFMA and a group of former SEC officials and law professors.

## Pending Petitions

**Insider trading.** In September, two hedge fund analysts filed a petition asking the Court to review their conviction for insider trading. In *Olan v. U.S.*, the petitioners had received information about a potential change in various Medicare reimbursement rates and then recommended that their employer trade based on that information. The fund that employed the analysts allegedly netted $3.5 million in illicit profits over the course of the scheme.

The analysts were convicted of a number of charges arising from the misappropriation of confidential information, including wire fraud and insider trading. The Second Circuit upheld the convictions in late 2019, finding that the *Dirks v. SEC* (1983) personal-benefit test does not apply in criminal prosecutions under the wire fraud and securities fraud provisions of Title 18 of the U.S. Code. The court also held that confidential government information may constitute "property" for purposes of the same statutes. A dissenting judge disagreed, however, with the holding that the predecisional information at issue constituted property of the agency or the government, arguing that such information has no economic impact on the government fisc until a regulation is issued and takes effect.

The petition asks whether the *Dirks* test requiring proof of personal benefit to establish insider trading applies to Title 18 statutes that proscribe fraud in language virtually identical to the Title 15 anti-fraud provisions at issue in *Dirks*. In this case, the analyst-petitioners made recommendations to their employer, but made no trading decisions and received a "miniscule" benefit at best, since their compensation was based on overall firm performance.

According to the petition, the Second Circuit read *Dirks* as establishing the personal-benefit test based on the statutory purpose of the Exchange Act to protect the free flow of information into the securities markets in part by "eliminating the use of inside information for personal advantage." This context does not exist for Title 18, but the petitioners argue that the provisions of Title 18 use identical language as the analogous antifraud provisions of the Title 15 securities laws. Nothing in *Dirks* limits the holding to Title 15 or suggests that the Court intended to implement a statutory purpose unique to Section 10(b) fraud cases.

As a result, the petitioners say, the Second Circuit has wrought a "sea change" that has erased the personal benefit requirement from criminal insider trading law. Financial professionals like the petitioners are now faced with a sweeping, amorphous prohibition on all trading in material non-public information, no matter how it was obtained, and market participants will be subject to criminal prosecution just for conducting analysis; this includes remote tippees like the petitioners, who are not alleged to have known who provided the information. The petitioners also conclude that the

 

Second Circuit's decision means that the government will never charge insider trading under Title 15 and will instead opt for Title 18 prosecutions that do not require proof of a personal benefit.

Next, in finding that the regulatory information was "property," the appellate court relied heavily on *Cleveland v. U.S.* (2000), which held that a gaming license was not "property" while in a state government's hands. The petition argues that the Second Circuit's holding conflicts with *Cleveland* and with the intervening decision in *Kelly v. U.S.* (2020), both of which foreclose wire-fraud prosecutions for conduct that causes the government no economic harm, and both of which would have come out the opposite way under the appeals court's analysis. The petitioners also argue that the holding transforms even state and local government information into government property, and in turn makes a federal crime out of a wide range of conduct traditionally regulated by state and local authorities.

The Solicitor General for the U.S. has urged the Court to grant the petition for certiorari, vacate the decision below, and remand the case. According to the memorandum, the Court decided *Kelly v. U.S.* after the Second Circuit issued its decision in this case. In *Kelly*, the Court held that a scheme to alter a regulatory decision that did not aim to obtain money or property could not have violated the federal-program fraud or wire fraud laws. While *Kelly* is discussed in the petition for certiorari, it was previously mentioned only in supplemental letters addressing the petitioners' motions to stay the court of appeals' mandate. A remand in light of *Kelly* is appropriate, the memorandum says, to allow the court to consider the issue in a different posture and then address it in a written decision.

**Regulation S-K disclosure.** The most recent petition, *M&T Bank Corporation v. Jarosalwicz*, asks the Court to examine the scope of Item 105 of Regulation S-K. Item 105 imposes an affirmative obligation to disclose material factors that make an investment in the registrant speculative or risky. In this case, M&T Bank filed a proxy statement pursuant to the precursor to Item 105 that discussed the risk factors of a proposed merger. Among the risk factors was the potential that regulators could delay or halt the transaction based on M&T's anti-money laundering efforts ("BSA/AML"). The company explained that it believed that its policies were compliant, but shortly before the shareholders voted, M&T announced that the Federal Reserve Board had identified concerns about its BSA/AML and that regulatory approval would be delayed (the Fed later approved the merger).

A class of shareholders brought a suit alleging that the proxy had omitted material risks associated with the merger, in violation of Exchange Act Section 14(a). The plaintiffs asserted, essentially, that M&T had negligently failed to discover its noncompliant practices and thus had failed to comply with Item 105. The district court dismissed the action, finding that regulatory risks had been adequately disclosed. In June 2020, the Third Circuit concluded that the BSA/AML deficiencies posed significant risks to the merger before M&T issued the proxy. Because the proxy omitted these material deficiencies and weaknesses, the plaintiffs met its pleading burden, the court said, adding that it did not matter whether or not M&T had actual knowledge of any shortcomings—the risk to the merger posed by an upcoming regulatory inspection triggered the need for disclosure.

The petition argues that the Third Circuit held that Item 105 requires issuers to disclose facts unknown to them at the time of disclosure and, further, to disclose uncharged, unadjudicated

 

wrongdoing. According to the petition, the Third Circuit's decision conflicts with the decisions of two other circuits regarding the scope of Item 105. First, in *Silverstrand Investments v. AMAG Pharmaceuticals* (2013), the First Circuit held that the plaintiffs stated an Item 105 claim where the defendant failed to disclose serious adverse events even though it knew about them. The Third Circuit splits from the First Circuit in not requiring actual knowledge of the allegedly-omitted facts; in this case, the plaintiffs did not allege that M&T knew of the BSA/AML deficiencies at issue—only that it "failed to detect" its alleged noncompliance. Unlike the Third Circuit, the First Circuit did not hold that knowledge of imminent regulatory scrutiny was enough to state a claim, which, the petition says, creates a split on the question of whether actual knowledge is required to trigger a disclosure obligation.

In the Second Circuit, the plaintiff in *City of Pontiac v. UBS AG* (2014) alleged that UBS AG violated Item 105 by failing to disclose that the bank was engaged in tax evasion, while disclosing that it was being investigated by the DOJ. Even though it ultimately was revealed that UBS had violated the tax laws, the Second Circuit rejected this argument, stating that Item 105 does not create a duty to disclose "uncharged, unadjudicated wrongdoing." If the Second Circuit's standard were applied here, the petition says, the Third Circuit would have dismissed the claim, but it instead distinguished M&T's disclosures as being more generic than UBS's. That case, however, did not rest on the specificity of the disclosures, the petition maintains, and the information at issue is exactly the sort of unadjudicated wrongdoing that the Second Circuit found to be outside of the ambit of Item 105.

The petition also observes that the SEC has never suggested that Item 105 requires disclosure of facts unknown to the company, and has, in fact, advised that disclosures are delimited by facts of which registrants are aware. And, asking companies to disclose unadjudicated wrongdoing means that they must judge the lawfulness of their own conduct, which can only be known in hindsight, the petition says. Indeed, at the time of the proxy, M&T believed that its procedures complied with the law, and said so. The petition asserts in conclusion that the Third Circuit has created a "nightmare scenario" in which as long as some high-level risk can be alleged, disclosure of unknown facts that later cause the risk to materialize would be required. A response is due on December 17, 2020.

**Administrative law judges.** Lastly, in *Gibson v. SEC* the justices are asked to consider the question of federal district court jurisdiction to hear constitutional challenges to the authority of the SEC's administrative law judges. Under the statutory review scheme set out in the Exchange Act, there is no right of judicial review (exclusively in the appropriate court of appeals) for structural constitutional challenges until there is a final order, and this is what the Eleventh Circuit and district court said in this case. Gibson argues that even though a traditional circuit split does not exist because the federal circuits agree that constitutional challenges to the SEC's ALJs can proceed via the statutory review scheme rather than in the district courts, this deprives respondents like Gibson from seeking relief in the federal district courts before they suffer the costs of defending against the SEC's charges.

In its response, the SEC notes at the outset that the Court has previously denied petitions raising questions similar to Gibson's (See *Tilton v. SEC*, cert denied and *Bebo v. SEC*, cert denied). Citing the *Thunder Basin* framework, the Commission argues that the statutory review scheme shows a clear intent by Congress to deny review in the district courts in cases like this and to provide for review in

 

the appellate courts. Plus, there is no conflict, as Gibson avers, with *Free Enterprise Fund v. PCAOB* since he was not required to preemptively commit a violation to get his matter heard. Instead, he is already subject to a pending proceeding, and his constitutional claims arise out of that proceeding. It is "natural" then, the Commission says, for Congress to insist that Gibson pursue his claims through the scheme established for reviewing that proceeding. Further, no court of appeals has found that the statutory review scheme may be bypassed. In the meantime, the expense and other burdens of litigation are "part of the social burden."

As the SEC says, this case presents a question that the Court has consistently declined to take up in the past, but there is at least a chance that the justices may take this opportunity to address the tenure protections afforded to ALJs. Gibson raised the issue before the administrative judge, who summarily rejected the separation of powers argument. His certiorari petition briefly asserted that the "layers of good-cause tenure" protection enjoyed by ALJs is incompatible with the Constitution's separation of powers (based on *Free Enterprise v. PCAOB*). This is noteworthy in the context of Justice Breyer's partial dissent in *Lucia v. SEC*, where he said that the Court deferred consideration of an "embedded" constitutional question whose answer would be necessary to addressing the Appointments Clause issue; that is, what is the constitutional status of the multiple layers of tenure accorded to SEC ALJs who enjoy "for cause" removal from office?

The Court's consideration of this issue may also be postponed until two more circuits consider it, as the issues presented in Gibson's case are pending in cases before the Fifth and Ninth Circuits. The SEC argues that either of these cases would be better vehicles than *Gibson,* because the plaintiffs have not yet had their evidentiary hearings; at this point, Gibson's proceedings before the ALJ are finished, and the case is before the Commission.

First, in *Cochran v. SEC*, the respondent in an SEC enforcement proceeding filed a suit in district court seeking to enjoin the action based on *Free Enterprise's* separation of powers holding. The Fifth Circuit affirmed the district court's dismissal for lack of subject matter jurisdiction and joined every circuit to reach the issue in concluding that the Exchange Act's judicial review scheme "exhibits a general intent to deprive district courts of subject matter jurisdiction." The court noted further that Cochran was not being deprived of her opportunity to raise a constitutional challenge to the removal of ALJs, but it would have to wait for judicial review in the appellate court, after the ALJ decides her case. The dissenting judge contended that Cochran's claim was really a "structural claim" that is not the type over which Congress intended to limit jurisdiction. The judge also pointed out that precluding jurisdiction could foreclose review because if Cochran wins her case, there will be no review, and her challenge would not be heard. The court has since vacated the panel opinion and granted rehearing en banc.

In the second case, the Ninth Circuit has heard arguments in a case involving the FTC, in which there is an essentially identical statutory review scheme to that governing the review of SEC actions. In *Axon Enterprise Inc v. FTC*, the district court concluded that Congress intended to preclude district courts from reviewing constitutional challenges and that exclusive jurisdiction lies with the appellate court. Oral arguments before the Ninth Circuit took place in July 2020, and the administrative proceeding has been stayed.

 

## Personnel changes and a shift in the Court

**Death of Justice Ginsburg.** On September 18, 2020, Justice Ruth Bader Ginsburg died at 87 as a result of complications of pancreatic cancer. In a public statement, the SEC commissioners praised "Justice Ginsburg's powerful intellect and determination," remarking that her career "will serve as a model of public service and dedication to our country for generations to come." President Trump praised her as a "titan of the law" and Vice President Pence stated that "she was a champion for women whose tireless determination reshaped our national life." After lying in repose at the Supreme Court and then at the U.S. Capitol, Justice Ginsburg was buried at Arlington National Cemetery on September 29, 2020.

While best known for her contributions to other areas of the law, she wrote several opinions that have had a significant impact on securities law. As discussed above, the *Goldman Sachs* petition hinges on the application of *Halliburton II*, in which Justice Ginsburg wrote a brief concurrence explaining that she joined with the majority based on the "understanding" that since it is incumbent upon the defendant to show the absence of price impact, no "heavy toll" would be placed on plaintiffs with "tenable claims." A year earlier, in early 2013, Justice Ginsburg wrote an opinion in *Amgen*, also key to *Goldman Sachs*, holding that proof of materiality is not a prerequisite to certification of a securities fraud class action.

Scienter is often a key element in securities fraud cases, and, in 2007, Justice Ginsburg penned *Tellabs Inc v. Makor Issues & Rights, Ltd.*, resolving a circuit split on what is meant by the PSLRA's requirement that there be a "strong inference" of scienter. Since *Tellabs*, courts must analyze whether the inference of scienter is "more than merely plausible or reasonable—it must be cogent and at least as compelling as any opposing inference of nonfraudulent intent." Justice Ginsburg also wrote the opinion in *Digital Realty Trust, Inc. v. Somers*, which focused closely on the letter of the law to hold that only whistleblowers who report directly to the SEC are protected against employment retaliation under the Dodd-Frank Act. As noted in our review of SEC regulatory developments, *Somers* was part of the impetus behind the SEC's recent revision of the regulations implementing the whistleblower program.

**Justice Barrett joins the Court.** Amy Coney Barrett was nominated to fill the vacancy left by the death of Justice Ginsburg on September 26, 2020. A former law professor, she had served as a judge on the Seventh Circuit Court of Appeals since late 2017. After contentious confirmation hearings in which all of the Democrats on the Senate Judiciary Committee boycotted the vote (some having stated that they viewed the nomination as illegitimate), Justice Barrett was confirmed on October 26, 2020 in a 52-48 vote (one Republican and every Democrat and Independent voted against her).

While on the Seventh Circuit, Justice Barrett authored no published opinions on federal securities matters. She had sat on the panel for some precedential matters, as well as a number of nonprecedential orders, but these offer no real insight into her views on the securities laws. In her short time on the Supreme Court, Justice Barrett has yet to be presented with the opportunity to comment on any securities-related matters, so her views on the subject are impossible to discern at this point. As a professor, however, she has written and spoken concerning her general views on the role of the judiciary. Most recently, during her speech accepting the nomination, Judge Barrett remarked on her

 

clerkship with Justice Scalia, noting his "incalculable influence" on her life. "His judicial philosophy is mine, too: A judge must apply the law as written," she said. Judges are not policymakers, she continued, and must set aside any such views that they might hold. As a professor, she wrote several law review articles discussing *stare decisis* and the tension between leaving the result of a precedent in place versus applying the logic of the precedent to a new context.

Justice Barrett's rise to the bench also means that there is now a larger conservative majority on the Court. Cases interpreting the securities laws sometimes split on partisan lines, and the judge's ideological leanings may inform their views of doctrines such as *stare decisis*. For example, in *Halliburton II*, Justices Thomas, Scalia, and Alito would have overruled *Basic*, while the majority emphasized *stare decisis* as a reason to uphold that case. Assuming the lineup remains stable, the direction of the court will become clearer as time goes on and more cases have been decided.

During the run-up to the 2020 presidential election, and in the wake of the passing of Justice Ginsburg, the idea of expanding the Court (i.e., "court packing") was resurrected and has gained momentum on the Left. While not explicitly endorsing this notion, the Biden administration may include a commission that will study reforming the federal court system. That said, Republicans currently control the Senate, but two runoff elections to be held on January 5, 2021 could determine the balance of power. If the Democrat candidates win both elections against GOP incumbents, the Senate would be split 50-50, and the Vice President would have the tie-breaking vote; even so, it is unlikely that even the Democratic senators would unanimously back a plan to expand the Court. Further, a group of Republican senators has introduced proposals aimed at keeping the Court at nine justices by amending the Constitution and by preventing legislation that would modify the number of justices.

In other news, on November 23, 2020, Senator Dianne Feinstein (D-Cal), who had served as ranking member of the Senate Judiciary Committee announced that she would be stepping down from that position. She indicated, however, that she would continue to serve as a senior Democrat on the committee. Senator Dick Durbin (D-Ill) then announced his intention to seek the top Democratic position on the committee. Durbin, the Senate Democratic Whip, has served on the committee for 22 years.

### The Court and COVID

Finally, 2020 will be remembered, among much else, as the year of the COVID-19 pandemic, and even the Supreme Court has been affected by the disruption engendered by the virus. As noted above, in response to COVID-19, the Court postponed oral arguments scheduled for the March session and the court building remains closed to the public. At the time, the Court placed its announcement in the historical context of postponed or shortened argument calendars in response to the 1918 Spanish flu epidemic and during yellow fever outbreaks in the 1790s. Since March, the justices have participated in conferences and oral arguments remotely via teleconference. Also, the confirmation hearings for Justice Barret were affected by a mini-outbreak among Republican officials, including President Trump and members of the Judiciary Committee, some of whom had attended Barrett's nomination ceremony; Barrett herself tested positive over the summer, but had tested negative at the

 

time of the ceremony. Whether any securities-related litigation involving the coronavirus in some way reaches the Court can only be a matter of speculation at this time, but the Court has issued orders in other areas, such as in applications seeking relief from restrictions imposed on gatherings for religious services.

## Conclusion

If the immediate past is prelude, then the 117th Congress may be a bumpy ride full of political messaging bills and rare instances of bipartisanship to move essential legislation. President-elect Biden has a reputation for working across the aisle, but questions remain whether those skills will serve him well in the current political environment. As a result, the passage of major financial legislation in the 117th Congress would seem unlikely, although smaller, more narrowly-targeted bills could be advanced on topics that have previously enjoyed bipartisan support, such as insider trading. The Supreme Court's future approach to securities cases is more difficult to predict because the justices can sometimes act in seemingly counterintuitive ways to reach majorities in difficult cases that ultimately break little new ground. The Roberts court has a history in securities cases of reaching narrow, incremental decisions, often with procedural components, that are also rooted in *stare decisis*. Several of the newer justices may hold views of *stare decisis* that could function to upset other areas of the law, but it remains to be seen if such views will be applied at all and, if they are, whether they will be applied to the same extent in securities cases.

The fact that this review of Congress and the Supreme Court in 2020 began and ended with discussions of COVID-19 demonstrates the prevalence and persistence of the virus that causes COVID-19 in the U.S. and around the world. As of publication, new vaccines are on the horizon but there is no escaping the awful human toll already exacted by COVID-19. In this second and last *Securities Regulation Daily* 2020 review of securities developments we pause to remember those who have been lost this year to COVID-19, some of whom undoubtedly were members of our legal profession. All of us at *Securities Regulation Daily* wish you and yours a safer, healthier, and happier New Year.

 