# SEC Enforcement: The Fourth Quarter of 2020

## Introduction

The fourth quarter of calendar year 2020 continued trends evidenced in the third quarter of the year, although far fewer cases were initiated. There were actions brought in a number of key areas such as offering fraud cases, those involving investment advisers and, importantly in the corporate disclosure and financial area.

The Commission was also able to address a key issue for its enforcement program – the statute of limitations. Two Supreme Court cases in recent years have addressed and limited the reach of the agency when seeking disgorgement by applying the statute of limitations. The Commission was able to secure a new statutory time limitation as the year closed, extending the former five year period to ten years. This issue and others are analyzed in four sections below: 1) Statistics; 2) Examples of the actions brought; 3) The Statute of Limitations; and 4) Conclusion.

## Statistics

Over the last calendar year the SEC filed over 60 enforcement actions, concluding the year with over 300 cases filed. As the year drew to a close, and in the face of a change of administration – the Chairman of the agency, the Director of Enforcement and others resigned effective December 31, 2020 – the Enforcement Division filed over 60 additional cases, primarily in December. The largest category of cases filed during the quarter were:

***Category Percentage of total***

Offering fraud 16%

Investment advisers 9%

Corporate disclosure 8%

Insider trading 5%

Conflicts 5%

As the table above demonstrates, a variety of cases were filed during the period in a series of categories. No group of cases represented more that the 16%, suggesting that the division had a broad focus during the period.

In contrast, in the third quarter of the calendar year the bulk of the cases initiated focused on microcap fraud, investment advisers and brokers. Indeed, most of the cases filed during that period fell into one of those categories.

Perhaps one of the most interesting category of cases are those grouped as corporate, disclosure. Cases in this group focus on corporate disclosure and financial issues tied largely, but not exclusively, to public companies. While the Commission has tried various approaches to rekindle actions in this group over the years, most have met with little success. The statistics from the last two quarters of the calendar year 2020 suggest that perhaps the agency has rekindled this traditional enforcement approach.

**Select Cases**

The following are significant actions brought during the fourth quarter of 2020. They are presented to highlight the approach used in different areas. The cases grouped by topic.

***Corporate, financial and disclosure***

*SEC v. Hill International, Inc.*, Civil Action No. 1:20-cv-02143 (E.D. Pa.) is an action which named as defendants the firm, former senior accountant Nicholas Tornello and others. The complaint alleged that the firm attempted to "bleed" losses out that were suffered as a result of foreign currency transactions rather than make the correct entries. Mr. Tornello consented to the entry of a permanent injunction based on Exchange Act Sections 13(a) and 13(b)(2)(A). In a related administrative action Mr. Tornello was suspended from appearing and practicing before the Commission as an accountant with the right to reapply after 1 year. The company and its former chief accounting officer previously settled with the Commission. *See* Lit. Rel. No. 4185 (Oct. 5, 2020).

*In the Matter of The Cheesecake Factory Incorporated*, Adm. Proc. File No. 3-20158 (December 4, 2020). Cheesecake Factory is a well-known national restaurant chain based in Calabasas Hills, California. The firm's shares are traded on Nasdaq Global Select Market. As the pandemic began to unfold Cheesecake Factory and other restaurant chains effectively had their businesses closed by the initial restrictions imposed which were designed to try and contain the virus. By mid-March 2020 Cheesecake Factory and others faced unprecedented challenges. Over the next month Cheesecake Factory took a series of steps to try and survive. Those included: 1) Efforts to conserve cash such as a March 18, 2020 letter sent to landlords saying that it would not be paying April rent, an event later reported in the media; 2) by March 23 the company was actively seeking additional liquidity through either debt or equity; possible private equity investors were told the company would survive at the current negative cashflow rate for about 16 more weeks – documents reflected a negative cash flow rate of $6 million per week; 3) a March 23 Form 8-K stated that the company was withdrawing prior financial guidance and moving to an "off-premise model" or delivery model was being installed to permit the firm to operate "sustainably;" 4) a March 27, 2020 Form 8-K stated the company was not planning to pay rent in April, that executive officers, board members and certain employees would take a pay cut and 41,000 workers were furloughed but allowed to retain certain benefits; 5) an April 3, 2020 Form 8-K filing attached an April 2 press release disclosing preliminary Q1 2020 sales noting that the restaurants were operating sustainably using the off-premises model; and 6) on April 20, 2020 Cheesecake Factory announced a $200 million subscription agreement for the sale of convertible preferred stock to a private equity investor. The Order alleges that the March 23 and April 3 Forms 8-K were false and misleading. The filings did not disclose that the firm was "excluding expenses attributable to corporate operations" from its discussions of "sustainability;" there was no statement that the negative cash flow was $6 million per week or only 16 weeks of cash remained as was stated to certain potential lenders. The Order alleges violations of Exchange Act Section 13(a). The firm, whose cooperation was considered by the Commission, resolved the matter, consenting to the entry of a cease-and-desist order based on the sections cited in the Order. The firm also agreed to pay a penalty of $125,000 that was transferred to the U.S. Treasury.

*In the Matter of Jason Boling, CPA,* Adm. Proc. File No. 3-20176 (Dec. 17, 2020) is an action which names as a respondent Mr. Boling, the CFO of Apex Global Brands, Inc. during the period here. Throughout 2017 Apex failed to properly record impairment charges tied to its primary assent and only revenue source – certain trademarks. During the period Apex was experiencing a series of significant setbacks in its business. Although the trademarks were impaired and there should have been charges of $34.5 million, they were not recorded. Mr. Boling was aware of the information regarding impairment but failed to require the write downs. The Order alleges violations of Exchange Act Section 13(b)(2)(A), charging that Respondent caused the violation. To resolve the proceedings, Respondent consented to the entry of a cease-and-desist order based on the Section cited in the Order. He also will pay a penalty of $10,000 which will be transferred to the Treasury. *See also In the Matter of Apex Global Brands Inc., FKA Cherokee Inc.,* Adm. Proc. File No. 3-20175 (Dec. 17, 2020)(based on conduct outlined above; resolved with cease and desist order based on Securities Act Section 17(a)(2) and (3) and Exchange Act Sections 13(a), 13(b)(2)(A) and 13(b)(2)(B) and the applicable rules).

*In the Matter of Dentsply Sirona Inc.,* Adm. Proc. File No. 3-20170 (Dec. 16, 2020) names the firm as a respondent, a seller of dental technologies equipment. DSI sold more of its product to an exclusive distributor for the U.S than the customer could sell. By the second quarter, DSI knew that the distributor wanted to renegotiate its deal. Indeed, in each quarter of the year DSI was aware of the trends or uncertainties and that they were reasonably likely to have a material and unfavorable impact on sales or revenues. Nevertheless, when preparing its filings, the trends were not disclosed. The Order alleges violations of Exchange Act Section 13(a) and Rules 12b-20 and 13a-13. To resolve the proceedings Respondent consented to the entry of a cease-and-desist order based on the Section and Rules cited in the Order. DSI also agreed to pay a penalty of $1 million which was transferred to the Treasury.

*SEC v. Luckin Coffee, Inc.,* Civil Action No. 1:20-cv-10631 (S.D.N.Y. Filed December 16, 2020). Luckin is a retail coffee provider, formed in the Cayman Islands and based in Fuijian, China. The firm's business model is premised on the assumption that there is a large, unmet demand for coffee in China. In May 2019 Luckin engaged in an IPO of ADS in the U.S., raising about $600 million. The materials reported that the company was formed in October 2017. By March 31, 2019 it was operating 2,370 stores in 28 cities across China. The company reported

16.8 million transacting customers. It had become China's second largest coffee store; it was the fastest growing coffee network. Luckin's goal was to be the largest coffee network. The prospectus acknowledged early losses. The same document reported that at year end 2018 Luckin had total revenue of USD $125 million. At the end of the first quarter of 2019 Luckin reported revenue of USD $71.3 million keyed to what was described as "strong growth." Luckin repeated its ambition to be the largest coffee network in China. In the months before the IPO kicked off, news reports highlighted the firm's "meteoric expansion" and its "stunning" and "super-charged" growth pattern at "break-neck speed." Luckin's initial pre-IPO valuation of USD $1 million in July 2018 was recalibrated to USD $2.2 billion by November 2018 to USD $2.9 billion in April 2019. In May 2019 the IPO price of USD $17 per share valued the company at USD $3.9 billion. Those numbers were the product of three fraudulent schemes tied to coupons that were controlled by insiders and executed over a few months. Revenue for coupons was recognized when it was used by the customer. These schemes generated over USD $300 million in total fabricated revenue. All of this revenue was carefully tracked on a parallel set of firm books. The finance department of Luckin only had access to the fake revenue books, not the real corporate books. The fraud emerged during an annual external audit for the Luckin's financial statements. Luckin then announced it. The share price dropped from USD $27.19 on March 31, 2020 to USD $3.39 per ADS on April 6, 2020. The complaint alleges violations of Securities Act Section 17(a) and Exchange Act Sections 10(b), 13(a), 13(b)(2)(A) and 13(b)(2)(B). Luckin took remedial acts and cooperated with the Commission. It resolved the case by consenting to the entry of permanent injunctions based on the Sections cited in the complaint. In addition, the company will pay a penalty of $180 million which may be offset by payments made to shareholder in the provisional liquidation in the Cayman Islands.

*In the Matter of Belden Inc.,* Adm. Proc. File No. 3-20169 (Dec. 14, 2020) is a proceeding which names the firm, a signal transmission solutions company, and its senior vice president of finance, Dennis Wiser, as Respondents. The case centers on the improper acceleration of revenue in 2017. Belden knew that there was a risk of improper acceleration at the company. In 2017 product was sold with the approval of Mr. Wiser, in a series of transactions were there was no reasonable chance it could be resold. It was not; then the product was returned. This occurred for $62 million of sales involving 140 transactions. The Order alleges violations of Securities Act Sections 17(a)(2) and (3) and Exchange Act Sections 13(a), 13(b)(2)(A), 13(b)(2)(B) and 13(b)(5). To resolve the proceedings each Respondent consented to the entry of a cease-and-desist order based on the Sections cited in the Order except the order as to the firm did not include Section 13(b)(5). Mr. Wiser was also denied the privilege of appearing and practicing before the Commission as an accountant with the right to reapply after three years. In addition, the company will pay a penalty of $650,000 while Mr. Wiser will pay $50,000. The funds will be transferred to the Treasury.

*SEC v. Sequentrial Brands Group, Inc.,* Civil Action No. 1:20-cv-10471 (S.D.N.Y. Filed Dec. 11, 2020) names as a defendant the New York based brand management company. The firm was required to test the good will carried on its balance sheet each year. At the end of 2016 and at the end of 2017 the firm did calculations using the same method. Both reflected impairment. Yet the firm failed to take the appropriate write downs. Specifically, Sequentrial Brands utilized an alternate method which permitted the company to claim there was no impairment. Following those calculations, and despite clear evidence of impairment at the end of 2016 and during the first three quarters of 2017, the firm failed to take write downs of about $100 million. This resulted in a material understatement of expenses and understatement of Sequentrial Brands' loss. The complaint alleges violations of Securities Act Section 17(a)(3) and Exchange Act Sections 13(a), 13(b)(2)(A) and 13(b)(2)(B). *See also SEC v. Seth*, Civil Action No. 0:20-cv-62563 (S.D.Fla. Filed Dec. 14, 2020)(names as a defendant Robert Seth who also participated in same scheme as an unregistered broker); *SEC v. Walker*, Civil Action No. 0:20-cv-62564 (S.D.Fla. Filed Dec. 14, 2020)(names as defendant Matthew Walker; based on same conduct as above). All of the cases are pending. *See* Lit. Rel. No. 24983 (Dec. 14, 2020).

***Broker-dealers***

*In the Matter of Robinhood Financial, LLC*, Adm. Proc. File No. 3-20171 (Dec. 17, 2020) is a proceeding which names the Commission and FINRA registered broker-dealer as a respondent. The proceedings center on the manner in which the firm secures the execution of customer orders, its compliance procedures and the statements made about those topics. Specifically, Robinhood's business mode requires that customers not be charged for the execution of orders. The firm secures payment by charging for order flow. From the beginning of its operations in 2015 through 2019 the firm demanded and was paid for order flow at prices that generally exceeded those of the market. As a result, the execution of Robinhood customer orders was slow – customers did not receive best execution. While the firm began to study the question in 2018 when the issue was raised in the market place, Robinhood continued to insist that customs received good execution. By 2019 the firm's internal analysis demonstrated this was incorrect. Until then Robinhood did not have policies and procedures in place that would have ensured proper execution. The Order alleges violations of Securities Act Section 17(a) and Exchange Act Section 17(a) and Rule 17a-4. To resolve the case the firm agreed to implement a series of undertakings. It also consented to the entry of a cease-and- desist order based on the Sections and Rule cited in the Order and to a censure. In addition, Robinhood agreed to pay a penalty of $65 million. A Fair Fund will be created.

*In the Matter of ITG Canada Corp. a/k/a Vortu ITG Capanda Corp.*, Adm. Proc. File No. 3-20182 (Dec. 21, 2020) names the Canadian registered broker as a Respondent. For example, during the period here the firm served as an intermediary in routing orders from Cormark Securities to the executing brokers. Many of the orders were mismarked in 2016 and 2017. During that period 200 orders marked as long were short since the underlying securities were not owned. Another 80 orders marked as long failed to deliver the securities. In fact, the orders were short under Regulation SHO. The Order alleges violations of Rules 200(g) and 203(b)(1) of Regulation SHO. To resolve the proceedings Respondent consented to the entry of a cease-and-desist order based on the Rules and Regulation cited. The firm will also pay a penalty of $200,000 that may be distributed through a Fair Fund. *See also In the Matter of Cormark Securities Inc.*, Adm. Proc. File No. 3-20181 (Dec. 21, 2020)(based on essentially the same facts with Cormak routing the mismarked orders; alleging violations of same Rules and Regulation; resolved with certain undertaking, a cease-and-desist order based on those Rules and the Regulation, and the payment of $800,000 penalty that may or may not be put in a Fair Fund).

***Investment advisers***

*In the Matter of EDG Management Company, LLC,* Adm. Proc. File No. 3-20133 (Oct. 22, 2020) is a proceeding which names as a Respondent the registered investment adviser. The operating documents provided that fees are calculated as 1.5% of investment capital with certain exceptions. One exception is where there are write downs. In a three-year period beginning in January 2016, and continuing until October 2019, there were certain write downs. Since those were not considered when calculating the fees; the limited partners were overcharged by about $83.9 million. The Order alleges violations of Advisers Act Sections 206(2) and 206(4). To resolve the proceedings Respondent consented to the entry of a cease-and-desist order based on the sections cited and to a censure. In addition, the firm will pay disgorgement and prejudgment interest in the amount of $1,026,642.02 which will go to the affected limited partners. The firm, in addition, will also pay disgorgement of $901,760.91 into a segregated account for the benefit of EDG Partners Fund II, LP. If those entitled to the disgorgement cannot be located the remaining sums will be transferred to the Treasury. Respondent will also pay a penalty of $175,000.

*SEC v. SAExploration Holdings, Inc.,* Civil Action No. 1:20-cv-08423 (S.D.N.Y.) an action which named as a defendant the company, a Huston based Seismic data firm and others in connection with an accounting fraud that improperly inflated the revenue by about $100 million. The fraud was based largely on inflating revenue in connection with a customer. In addition, two executives were alleged to have misappropriated millions of dollars. The company consented to the entry of a permanent injunction based on Securities Act Section 17(a) and Exchange Act Sections 10(b), 13(a), 13(b)(2)(A) and 13(b)(2)(B). In resolving the case the agency acknowledged the remedial acts of the company following an investigation by a special committee of the board. Those acts included removing two former executives engaged in the fraud and timely providing the staff with facts developed during the investigation. The litigation as to the two executives continues. *See* Lit. Rel. No. 24988 (Dec. 18, 2020).

*In the Matter of Voya Financial Advisors, Inc.,* Adm. Proc. File No. 3-20183 (Dec. 21, 2020) is an action which names the registered investment adviser as a Respondent. Voya Financial breached its duty in three respects. First, over a five year period beginning in 2013 the firm failed to disclose it received 12b-1 fees on transactions involving certain shares. Second over the same the firm failed to disclose that it was paid certain fees from an unaffiliated clearing broker for transactions with some clients. Third, over a four-year period beginning in 2013 the firm did not disclose that it caused certain advisory clients to pay higher fees in the form of upfront fees when buying certain illiquid products at times when the same products were available with commissions waived for advisory clients. The Order alleges violations of Advisors Act Sections 206(2) and 206(4). To resolve the proceedings Respondent agreed to implement a series of undertakings and consented to the entry of a cease-and-desist order based on the Sections cited in the Order and to a censure. Voya will also pay disgorgement of $11,547,820, prejudgment interest of $2,371,335 and a penalty of $9 million. A fair fund will be created for all of the monetary amounts paid.

***Insider trading***

*SEC v. Peltz,* Civil Action No. 1:20-cv-06199 (E.D.N.Y. Filed Dec. 22, 2020) is an action which names as a defendant Jason Peltz, the creator of a music based mobile computing application. Prior to the publication of a new article noting that Ferro Corp. would be acquired, a member of the Ferro Board tipped Mr. Peltz about the pending deal. Mr. Peltz then purchased Ferro securities through the account of another and an offshore account. He also tipped five people. The seven accounts connected to Mr. Peltz had about $1 million in profits. About 2 weeks after the news article, one account transferred $99,000 to an entity partially owned by Defendant. The overseas entity transferred almost $1 million to a company controlled by the Board member. The complaint alleges violations of Exchange Act Section 10(b). The case is pending. *See* Lit. Rel. No. 24998 (Dec. 29, 2020). A parallel criminal case was filed by the U.S. Attorney's Office for the Eastern District of New York.

***Offering fraud***

*SEC v. Capsource, Inc.,* Civil Action No. 02303 (D.Nev. Filed Dec. 21, 2020) is an action which names as defendants, the firm, Stephen J. Byrne and Gregory P. Herlean. The firm facilitates real estate related lending; Mr. Byrne is the founder and owner of the firm; and Mr. Herlean is a member of the company executive committee and a 30% owner of the firm. Over a four-year period the company offered and sold over $151 million of securities in unregistered offerings. Portions of the funds were diverted to the largest client of the company which used them for its real estate projects, to prop up the company which was experiencing financial difficulties and to support a related drug rehabilitation project, all contrary to the representations made to investors. The complaint alleges violations of Sections 5(a), 5(c) and 17(a) and Exchange Act Sections 10(b) and 15(a). The case is pending. *See* Lit. Rel. No. 24992 (Dec. 21, 2020); *See also SEC v. Zipprich*, Civil Action No. 2:20-cv-02308 (D.Nev. Filed Dec. 21, 2020)(action naming as defendants Michael Zipprich, America's Rehab Campuses, LLC, and Arizona Rehab Campus, LLC; related action based on participation by rehab facility and its associates; alleging violations of same Securities Act Sections as above plus Exchange Act Section 20(a)). The case is pending.

***Muni bonds***

*In the Matter of First Midstate Inc.*, Adm. Proc. File No. 3-20187 (Dec. 22, 2020) names as Respondents the firm, a broker-dealer and municipal advisor, and Paul D. Brown, the president and COO of the company. Beginning in 2014, and continuing until 2018, the firm advertised on its website and in other places that it had an extensive customer base to which it marketed muni bonds. In fact, it did not. To the contrary, most of the bonds that the firm sold were to other broker-dealers. Investors also were required to pay higher prices and accept lower yields for the bonds. The Order alleges violations of Exchange Act Section 15(B)(c)(1) and MSRB Rules G-17 and G-21. To resolve the matter, the firm and Mr. Brown agreed to implement certain undertakings, consented to the entry of a cease-and-desist order based on the Section and rules cited in the Order and agreed to pay a penalty of $175,000, $55,333 of which will be transferred to the MSRB. Mr. Brown will also pay a penalty of $25,000.

***Crypto***

*In the Matter of ShipChain, Inc.,* Adm. Proc. File No. 3-20185 (Dec. 21, 2020) is a proceeding which names the shipping and logistics firm as a Respondent. Over a period of months, beginning in late 2017, ShipChain sold over 145 million digital assets or SHIP tokens in an initial coin offering. Investors were told the funds would be used to develop a blockchain platform and jumpstart the ShipChain economy. The Order alleges violations of Securities Act Sections 5(a) and 5(c). To resolve the proceedings Respondent agreed to implement certain undertakings and consented to the entry of a cease and desist order based on the Sections cited in the Order. Respondent will also pay a penalty of $2,050,000. A Fair Fund will be created.

***Offering fraud***

*SEC v. Capsource, Inc.,* Civil Action No. 02303 (D.Nev. Filed Dec. 21, 2020) is an action which names as defendants, the firm, Stephen J. Byrne and Gregory P. Herlean. The firm facilitates real estate related lending; Mr. Byrne is the founder and owner of the firm; and Mr. Herlean is a member of the company executive committee and a 30% owner of the firm. Over a four-year period the company offered and sold over $151 million of securities in unregistered offerings. Portions of the funds were diverted to the largest client of the company which used them for its real estate projects, to prop up the company which was experiencing financial difficulties and to support a related drug rehabilitation project, all contrary to the representations made to investors. The complaint alleges violations of Sections 5(a), 5(c) and 17(a) and Exchange Act Sections 10(b) and 15(a). The case is pending. *See* Lit. Rel. No. 24992 (Dec. 21, 2020); *See also SEC v. Zipprich,* Civil Action No. 2:20-cv-02308 (D.Nev. Filed Dec. 21, 2020)(action naming as defendants Michael Zipprich, America's Rehab Campuses, LLC, and Arizona Rehab Campus, LLC; related action based on participation by rehab facility and its associates; alleging violations of same Securities Act Sections as above plus Exchange Act Section 20(a)). The case is pending.

**Statute of Limitations**

The Supreme Court significantly limited the SEC's ability to seek disgorgement in two decisions. Specifically, the Court held that disgorgement must be limited to the wrongdoer's "net profits" and be awarded "for victims." The Court rejected the expansive concepts used by the agency for years. Essentially, the remedy was returned to its historic roots, as reflected in the opinion written by Justice Sotomayor for the Court. *Liu v. Securities and Exchange Commission,* No. 18-1501 (June 22, 2020).

The Court also held that the five-year statute of limitations applies to any award of disgorgement. *Kokesh v. SEC,* 137 S.Ct. 1635 (2017). On remand the agency was unable to cobble together a "continuous violation" theory together to effectively expand the 5 year period. *See, e.g. SEC v. Kokesh,* No. 15-2087 (10th Cir. Decided March 5, 2018).

As 2020 drew to a close, the agency was able to resolve the question of its authority to seek disgorgement presented and resolved in favor of the agency in *Liu* and the 5 year time limitation.

In the National Defense Authorization Act passed by both houses of Congress over the veto of the president as they year ended, both questions were addressed. Section 6501 of the Investigations and Prosecution of Offenses for Violations of the Securities Laws included in the Act modified Exchange Act Section 21(d). 6501(a)(7). The Act also provides that the agency can reach back up to 10 years rather that the five previously permitted. Under current law Section 6501(a)(8)(extends statute of limitations to 10 years). *See also* Section 6501(a)(8)(B)(can seek equitable remedies including in junction, bar, cease and desist order for up to 10 years).

**Conclusion**

The Commission ended calendar year 2020 on a high note after bringing a large number of cases in the third quarter and very few in October and November. More importantly – and recall that the number of cases is not the measure of an enforcement program – a wide variety of actions were initiated, helping broaden the program as was done in earlier quarters. Perhaps most significant, the quarter continued a trend tracing at least to the third quarter of bringing a number of corporate, disclosure and financial cases, a traditional mainstay of the enforcement program that has been absent to a significant degree over the last several years.