Federal Securities Law: 2020 Year End

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Securities and Exchange Commission Chairman Jay Clayton has announced that he will end his time as Chairman "at the end of this year."[1] In contrast, his predecessor SEC Chair Mary Jo White announced her departure "at the end of the Obama Administration."[2] Who becomes Chairman on January 1, 2021? Under 17 CFR 200.10, the Chairman of the SEC is designated by the President pursuant to the provisions of section 3 of Reorganization Plan No. 10 of 1950.[3] Section 3 provides, "[T]he functions of the Commission with respect to choosing a Chairman from among the Commissioners composing the Commission are hereby transferred to the President."[4]

So who will serve as Acting Chairman? Reorganization Plan No. 10 limits the choices to "from among the Commissioners." President Trump will likely choose between Commissioner Hester M. Peirce and Commissioner Elad L. Roisman, both Republicans, to serve as Acting Chairman from January 1 until such time on or after January 20, 2021 when, after taking the oath of office, President Biden designates one of the other current Commissioners, likely either Commissioner Allison Herren Lee or Commissioner Caroline A. Crenshaw, both Democrats, as Acting Chairwoman until his nominee for the Chair is confirmed by the Senate. Departing Chairman Clayton is an Independent. So, as has happened before, a two-two split will exist among the Commissioners, at least on a party affiliation basis. Will the Commission become as polarized as the rest of Washington?

Looking back over the past year, the partisan divide among SEC Commissioners does not resemble that exhibited on the national or state level, let alone the nation's capital. Of the 949 Final Commission Votes for Agency Proceedings in 2020, the vast majority were votes of unanimous approval.[5] When split voting occurred, it was on matters such as expanding access to private markets, with "no" votes from Commissioners Lee and Crenshaw (or Crenshaw's predecessor, Commissioner Robert J. Jackson, Jr.) because of inadequate individual investor protection, as described in this column last quarter.[6] On matters of enforcement, "no" votes were rare, such as that of Commissioner Peirce in a Securities Act Section 5 registration violation case absent any fraud.[7] Unanimity prevailed, qualified by occasional "yes, with exception" votes by Commissioner Pierce voting to approve but taking exceptions to the imposition of disgorgement or certain penalties under the about to be issued Commission order.[8]

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[1] SEC Press Release No. 2020-284 *SEC Chairman Jay Clayton Confirms Plans to Conclude Tenure at Year End* (Nov. 16, 2020), *available at*: https://www.sec.gov/news/press-release/2020-284

[2] SEC Press Release No. 2016-238 *SEC Chair Mary Jo White Announces Departure Plans* (Nov. 14, 2016), *available at*: https://www.sec.gov/news/pressrelease/2016-238.html

[3] https://www.ecfr.gov/cgi-bin/text-idx?node=17:3.0.1.1.1&rgn=div5#se17.3.200_12

[4] https://uscode.house.gov/view.xhtml?req=granuleid:USC-prelim-title5a-node84-leaf114&num=0&edition=prelim

[5] Commission votes, January through October 2020: https://www.sec.gov/about/commission-votes/annual/commission-votes-ap-2020.xml November 2020: https://www.sec.gov/about/commission-votes/2020/commission-votes-2020-11.xml

[6] See *Federal Securities Law*, The Bond Lawyer, Vol 44, No. 3, Summer 2020.

[7] In the Matter of Unikrn, Inc. Sec. Act Rel. No. 10841 (Sept. 15, 2020), *available at*: https://www.sec.gov/litigation/admin/2020/33-10841.pdf

[8] N. 5, *supra*.

The two-two split will not end until the confirmation and swearing-in of a Chairman nominated by President Biden and confirmed is by the Senate. When that will be is hard to predict. The speed with which his nominee is confirmed may depend in great part upon the majority party in the Senate following the January 5, 2021 runoff elections in Georgia. Should the Republicans retain the majority, the policy orientation of the confirmed nominee may differ as well. It is fair to say that among more obvious consequences, on January 5, 2021 the good citizens of the State of Georgia may exercise influence on federal securities regulatory policy.

Current Rulemaking

Before we know the outcome of the Georgia races for U. S. Senate, the *Order Granting a Temporary Conditional Exemption from the Broker Registration Requirements of Section 15(a) of the Securities Exchange Act of 1934 for Certain Activities of Registered Municipal Advisors* (the "Order")[9] expires on December 31, 2020, Chairman Clayton's last day on the job. The Order, recall, has temporarily exempted independent municipal advisors from registering as broker-dealers when they assist issuers in placing municipal securities under limited circumstances. In the Order, the Commission states that it "intends to continue to monitor the situation as it develops. The Temporary Conditional Exemption may be modified as appropriate."[10] To date, neither the Chairman nor the Office of Municipal Securities has indicated whether the Exemption may be extended. The Order was approved unanimously on June 16, 2020 by the then four Commissioners. Commissioner Crenshaw had not yet been confirmed to fill the seat vacated by Commissioner Jackson. Has it been useful? The SEC's Office of Municipal Securities reports that as of November 30, 2020, 148 issuers directly placed a total of 151 issuances since the Order became effective.[11] The 101 issuers and 112 issuances for the period October 1 through November 30, 2020 tripled the combined totals of 37 issuers and 39 issuances for the period June 16 through September 30, 2020.

The Order has been challenged by the Securities Industry and Financial Markets Association (SIFMA), which petitioned the United States Court of Appeals for the District of Columbia Circuit for review of the Order on August 14, 2020, as noted in this column last quarter.[12] SIFMA filed its brief on November 30, 2020. The SEC brief is due December 30, 2020, SIFMA's reply brief is due January 20, 2021, and final briefs are due February 10, 2021.[13]

SIFMA's Initial Brief[14] presents three arguments: ***first***, the Order violates the Administrative Procedure Act because the Commission did not give interested parties notice and an opportunity to comment, arguing (a) the Order is subject to APA notice and comment requirements, and (b) any

[9] Rel. No. 34-89074 (June 16, 2020), *available at*: https://www.sec.gov/rules/exorders/2020/34-89074.pdf
[10] Id.
[11] https://www.sec.gov/files/data-for-reporting-period-061620-093020.pdf
[12] N. 6, *supra*.
[13] General Docket United States Court of Appeals for District of Columbia Circuit, Court of Appeals Docket #: 20-1306 Docketed: 08/14/2020 Securities Industry v. SEC.

[14] Securities Industry v. SEC, Initial Brief for Petitioner, Document # 1873502, filed 11/30/2020.

purported exigency did not excuse the Commission from those requirements; ***second***, the Order violates the APA because it is arbitrary and capricious, arguing (a) the Commission provides no coherent rationale for the Order, (b) information available to, but ignored by, the Commission refutes the core factual premise of the Order, and (c) the Order imposes irrational distinctions between broker-dealers and municipal advisors engaged in the same conduct; and ***third***, even though the Order may expire at the end of this year, SIFMA's challenge to the Order will not become moot.[15]

The third argument provides a response to the question most likely to have popped into readers minds given what appears to be the built in shelf life of the December 31, 2020, expiration date of the Order: *won't this all be moot before the briefing is over?* SIFMA anticipates this question and provides the response below. Here's an excerpt from the Brief:

> The Commission cannot evade this Court's review of this infirm agency action by arguing that the petition will become moot before this case can be decided. The petition will not become moot at the end of 2020 for several reasons.
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> First, even if the 2020 Order nominally expires, this Court ought to remain "unpersuaded that the [Commission] has committed to this course permanently" and thus should hold that the Commission's voluntary cessation of the challenged exemption does not moot this matter. Mhany Mgmt., Inc., 819 F.3d at 604. The Commission's express reservation of the right to "monitor the situation" and modify the temporal scope of the 2020 Order makes clear that the Commission has not conclusively ended the challenged conduct, but rather may reinstitute the exemption at any time, without notice. 2020 Order at 11 (JA __). And the fact that the Commission previously proposed the same substantive exemption reinforces the conclusion that the Commission is certainly not "permanently" committed to abandoning its course. See Initiative & Referendum Inst., 685 F.3d at 1074 (noting that challenge to a superseded law is not rendered moot where "there [is] evidence indicating that the challenged law likely will be reenacted" (internal quotation marks omitted)); see also City of Mesquite v. Aladdin's Castle, Inc., 455 U.S. 283, 289 n.11 (1982) (concluding that the case was not moot where the city had announced its intent to reenact the challenged ordinance). This is exactly the type of case where the Commission has "voluntarily ceased an informal action but might reinstate the same action [with another, similar order] at any time." Clean Water Action v. Pruitt, 315 F. Supp. 3d 72, 87 (D.D.C. 2018).
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> Moreover, "suspicious timing and circumstances pervade the [Commission's] decision" to include a termination date in the 2020 Order and these "suspicious" circumstances should preclude a finding of mootness. Mhany Mgmt., Inc., 819 F.3d at 604. The 2020 Order implemented a substantive change in the law without notice or public comment, despite the Commission's previous acknowledgment that notice and comment were appropriate to create the same exemption, and despite electing not to proceed with implementing the same exemption when it had been subjected to the notice-and-comment process. The Commission then conditionally limited the duration of the 2020 Order, allowing it to be extended indefinitely at the Commission's whim if it went unchallenged, but also conveniently creating an expiration date that would terminate the 2020 Order before review could be completed if

[15] Id.

> any legal challenge to the 2020 Order's validity were raised. Given the Commission's past experience with the substantive content of the 2020 Order, the Commission clearly had reason to suspect that the 2020 Order would not survive a direct challenge under the APA. This, coupled with the suspiciously flexible temporal design of the 2020 Order, constitutes the exact type of "suspicious timing and circumstances" that should not lead to a finding of mootness, see id., as it suggests that the termination of the 2020 Order was not "unrelated to the [probability of] litigation" challenging its legality, see Leonard v. U.S. Dep't of Def., 598 F. App'x 9, 10 (D.C. Cir. 2015) (internal quotation marks omitted).
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> Second, for similar reasons, the fact that the 2020 Order may expire at the end of 2020 will not moot SIFMA's petition because the Commission's action is capable of repetition while evading review. "[A]gency actions of less than two years' duration cannot be fully litigated prior to cessation or expiration, so long as the short duration is typical of the challenged action." Del Monte Fresh Produce Co. v. United States, 570 F.3d 316, 322 (D.C. Cir. 2009) (internal quotation marks omitted). And, as shown above, the circumstances here, including the Commission's express warning that it may revise or reinstate the 2020 Order without notice, 2020 Order at 11 (JA __), plainly suggest the possibility of recurrence.[16]

We'll see what the SEC has to say December 30.

Additional Considerations on Regulation S-K Amendments

This column last quarter took a brief look at the amendments adopted by the SEC to modernize the disclosure for General Development of Business (Item 101), Legal Proceedings (Item 103), and Risk Factors (Item 105)[17] that registrants are required to make pursuant to Regulation S-K and promised that "more will follow" in this column.[18] The rule amendments became effective November 9, 2020.

As noted in last quarter's column, since municipal securities offerings are almost always exempt from registration with the SEC, the amendments have no mandated impact on municipal securities disclosure. However, the line item disclosure requirements of Regulation S-K have served as a point of reference for disclosure in offerings of private activity bonds backed by corporate credits, given the absence of bright line disclosure rules for exempt offerings. Accordingly, the amendments could affect disclosure practices in such offerings.

For disclosure in other offerings of municipal issuers, the revisions to Regulation S-K may be worthy of consideration when confronting a new or infrequently addressed disclosure topic, particularly in light of their contemporary nature.

Purpose. The final rule, citing the 2019 proposal, explains the intention of the rulemaking as "to improve these disclosures for investors and to simplify compliance for registrants." Among other matters, the Commission "considered the many changes that have occurred in our capital markets and

[16] Id.
[17] Modernization of Regulation S-K Items 101, 103, and 105, Release Nos. 33-10825; 34-89670 (Aug. 26, 2020), *available at*: https://www.sec.gov/rules/final/2020/33-10825.pdf
[18] N. 6, *supra*.

the domestic and global economy in the more than 30 years since the adoption of these disclosure requirements, including changes in the mix of businesses that participate in our public markets, changes in the way businesses operate, changes in technology (in particular technology that facilitates the provision of, and access to, information), and other changes that have occurred simply with the passage of time."[19]

The Commission prefaces its description of the changes by noting:

> Many of the amendments reflect our long-standing commitment to a principles-based, registrant-specific approach to disclosure. Our disclosure requirements, while prescriptive in some respects, are rooted in materiality and facilitate an understanding of a registrant's business, financial condition and prospects through the lens through which management and the board of directors manage and assess the performance of the registrant.[20]

This statement is followed by a table displaying the respective Items, the Existing Item Requirement and a Summary of the Final Amendments, describing the principles-based requirement.

General Development of Business (Item 101). For example, the existing requirement for "description of the general development of the business of the registrant during the past five years, or such shorter period as the registrant may have been engaged in business" has eliminated the five-year time frame and is now "largely principles-based, requiring disclosure of information material to an understanding of the general development of the business."[21] The measure of appropriate disclosure is providing an understanding of the general development of the business, not presentation of a narrative satisfying a specific period of time. The pages saved by removal of a five-year narrative come with the price of determining whether a shorter or longer period of time is required to provide investors with a materially accurate understanding of the general development of the business.

Legal Proceedings (Item 103). Existing Item 103 requires disclosure of any material pending legal proceedings, other than ordinary routine litigation incidental to the business, to which the registrant or any of its subsidiaries is a party or of which any of their property is the subject. Item 103 also requires disclosure of the name of the court or agency in which the proceedings are pending, the date instituted, the principal litigants and a description of the alleged factual basis for the proceeding and the relief sought. Similar information is required for proceedings known to be contemplated by governmental authorities. The Commission points out that this topic has been required disclosure since 1933, included in then Form A-1 when the Securities Act was administered by the Federal Trade Commission.[22]

The revisions provide a practical solution to avoid repetitive disclosure otherwise required under Item 103 and elsewhere, such as Management's Discussion & Analysis, Risk Factors, or notes to the

[19] 85 F. R. 63726, 63727 (Oct. 8, 2020).
[20] Id.
[21] Id. at 63728. Similar descriptions of the principles-based replacement requirements run throughout the final rule. I have previously expressed frustration with the use by the Staff of "principles-based" without explanation in rulemaking and guidance on municipal disclosure. The final rule is welcome contrast.
[22] Id. at 63740

financial statements: they expressly permit hyperlinks or cross references.[23] Prior to the amendment, Item 103 required specific disclosure of any proceeding under environmental laws to which a governmental authority is a party unless the registrant reasonably believes it will not result in sanctions of $100,000 or more, a threshold in effect since 1982. Under the revisions, the threshold was increased to $300,000 (rounding up from an inflation adjusted amount calculated at $285,180.40), or at the election of the registrant, such other amount that the registrant determines is reasonably designed to result in disclosure of any such proceeding that is material to its business or financial condition, except that disclosure is required for any proceeding in which the potential monetary sanctions exceed the lesser of $1 million or one percent of the current assets of the registrant and its subsidiaries on a consolidated basis. The latter threshold serves the purpose of providing information important to investors in assessing a registrant's environmental compliance as well as possible illegality and conduct contrary to public policy, which without the $1 million cap would not be disclosed as immaterial in the case of large registrants.

Risk Factors (Item 105). Prior to the amendments, Item 105 required disclosure of the most significant factors that make an investment in the registrant or offering speculative or risky and specified that the discussion should be concise and organized logically. Item 105 further directed registrants to explain how each risk affects the registrant or the securities being offered, discouraged disclosure of risks that could apply generically to any registrant, and requires registrants to set forth each risk factor under a sub-caption that adequately describes the risk.

In amending Item 105, the Commission aimed to address the lengthy and generic nature of the risk factor disclosure presented by many registrants. Including generic, boilerplate risks that could apply to any offering or registrant appeared to have contributed to the increasing length of risk factor disclosure over time. Although Item 105 instructed registrants not to present risks that could apply generically to any registrant, and despite longstanding Commission and staff guidance that risk factors should be focused on the "most significant" risks and should not be boilerplate, it is not uncommon for companies to include generic risks. Registrants often disclose risk factors that are similar to those used by others in their industry without tailoring the disclosure to their circumstances and particular risk profile. To address these concerns, under the amendments:

- If a registrants' risk factor disclosure exceeds 15 pages, a series of concise, bulleted or numbered statements summarizing the principal factors that make an investment in the registrant or offering speculative or risky is required in the forepart of the document;

- Registrants are required to disclose the material factors (not, as previously, "most significant") that make an investment in the registrant or offering speculative or risky; and

- Registrants are required to (a) organize their risk factor disclosure under relevant headings in addition to the subcaptions that are currently required and (b) present risks that could apply to any registrant or any offering at the end of the risk factor section under a separate caption entitled "General Risk Factors."

[23] Id.

Concluding Thoughts

Some perspective on Presidential transition and the SEC may be offered by, from what seems today as a much less turbulent time, the 1993 transition from President George H. W. Bush to President Clinton. Then SEC Chairman Richard C. Breeden, whose term would not expire until June 1993, announced in February 1993 (after the inauguration of President Clinton) that he would step down as SEC Chairman by April 15, 1993. On April 15, as reported in The New York Times, he announced "he would stay until the end of the month and possibly longer … 'to complete certain pending S.E.C. actions' and accommodate the confirmation of his successor." [24] As noted in the article "The White House confirmed that Mr. Breeden had been asked to stay on temporarily." On Saturday, May 8, 1993, following Chairman Breeden's announcement of his resignation, President Clinton appointed Commissioner Mary L. Schapiro as acting Chairwoman.[25] Chairman Breeden left the SEC the following Thursday May 13. It is difficult to identify today the reasons behind the timing of Chairman Breeden's departure, but it is interesting to note a story reported May 4, 1993 above the fold of The New York Times front page four days prior to the appointment of acting Chairwoman Schapiro. The story reported federal investigations centered on transactions in New Jersey Turnpike bonds and a bond consultant firm in Camden County partly owned by the chief of staff for the Governor of New Jersey, matters brought to the attention of federal authorities by an underwriting firm following its own internal investigation.[26] Chairman Clayton is leaving town early, nothing would appear to entice him to stick around. For the rest of us, we will soon learn what voters in the State of Georgia have in store.

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[24] *S.E.C. Head Delays Leaving*, The New York Times, April 15, 1993, p. D 8, *available at*: https://timesmachine.nytimes.com/timesmachine/1993/04/15/903893.html?pageNumber=72
[25] *Acting Chief for S.E.C.* The New York Times, May 8, 1993, p. 48, *available at*: https://timesmachine.nytimes.com/timesmachine/1993/05/08/847993.html?pageNumber=47
[26] *Broker Suspends 3 Over Bond Deal With New Jersey*, The New York Times, May 4, 1993, p. 1, *available at*: https://timesmachine.nytimes.com/timesmachine/1993/05/04/issue.html; *A Cleanup for New Jersey Bonds*, The New York Times, May 7, 1993, p. 30, *available at*: https://timesmachine.nytimes.com/timesmachine/1993/05/07/551893.html?pageNumber=30