

Top SEC Controversies In 2022: Midyear Report

By **Al Barbarino**

Law360 (July 8, 2022, 4:47 PM EDT) -- U.S. Securities and Exchange Commission Chair Gary Gensler has moved swiftly to introduce a variety of progressive and often controversial rulemaking proposals, Congress has attempted to delegate how the SEC should approach crypto regulation, and the agency's in-house court system has sustained relentless attacks.

The rulemakings have fostered intense debate, as they touch on contentious issues like climate risk disclosures, corporate board diversity, and the regulation of SPACs and private funds. Critics have also blasted the agency for providing shorter comment periods across the board.

When the agency revealed its spring agenda last month, Republican Commissioner Hester Peirce, who the industry nicknamed "crypto mom," noted that the agenda lacks a proposal aimed at the "main regulatory questions" surrounding the crypto market. A bipartisan bill proposal in Congress last month sought to hash those details out, but not without creating an apparent rift between the SEC and another top financial regulator.

Meanwhile, the agency's in-house legal system, often criticized as having an unfair home-court advantage, was dealt a blow by a divided Fifth Circuit that said the courts are unconstitutional. The U.S. Supreme Court may ultimately have the final say.

These are among the top debates that have rocked the SEC so far in 2022. Here, attorneys who specialize in financial and securities law spoke with Law360 about how they see them unfolding in the latter half of the year.

Crypto Regulation: Who's in Charge?

A bipartisan House bill would give the CFTC authority to regulate the bulk of crypto by market cap, including the popular bitcoin and ether coins, deeming them "ancillary" assets and stores of value, and thus commodities. The SEC would take authority over most of the rest of digital assets, as they mimic securities.

CFTC Chair Rostin Behnam said the proposal gets the regulatory balance right. Meanwhile, SEC Chair Gensler suggested at an industry event that the bill could inadvertently undermine market protections.

"With crypto becoming a significant financial asset in recent years, there's naturally been more interest from regulators and Congress to wrap their arms around it and make sure the space is regulated

appropriately," said Dustin Nofziger, counsel in Pryor Cashman LLP's financial institutions group.

It seems unlikely the bill will pass this year, with midterm elections ahead and Republicans poised to possibly take over the House, experts said. But the bill is "evidence of bipartisan interest in providing greater regulatory clarity on digital assets," Nofziger said.

It also remains to be seen how the crypto market's recent crash, which erased some \$2 trillion of its nominal market value, could affect the motivations of lawmakers.

"On one hand, if the crypto market continues to decline it could take some of the air out of the sails for Congress to act," Nofziger said. "On the other hand, a continued decline could act as a countervailing force that pushes for additional regulatory clarity to protect retail investors even if cryptocurrency doesn't take over the world."

Erin Martin, a Morgan Lewis LLP partner who spent 13 years at the SEC, said she "didn't get the sense that [Gensler] was a big supporter of the initiative" based on his recent comments.

She pointed out that the spring SEC agenda doesn't have a crypto-specific proposal, which she said appears to fall in line with Gensler having been "somewhat consistently resolute in his belief that the current regulatory regime works."

Martin added that while the proposal is unlikely to pass in its current form, it could serve as a building block for lawmakers after the midterm elections.

"Generally speaking, I think we could all agree that given the significant divide in American politics, whenever there is bipartisan support for an initiative it does show signs of likelihood of movement," Martin said.

A Climate Proposal Inflames

A March rulemaking proposal that would require a slew of new climate-risk related disclosures from all public companies incited fierce debate right up until the deadline for comment letters on June 17.

The rule would require companies to disclose greenhouse gas emissions and the business risks related to severe weather and the transition to lower carbon emissions.

Concerns include the costs and burdens and the feasibility of tracking down certain indirect greenhouse gas emissions data, known as Scope 3 emissions. One point of contention is whether the SEC even has the authority to impose the rules.

Kurt Wolfe, of counsel in Quinn Emanuel Urquhart & Sullivan LLP's SEC enforcement practice, says that wherever the SEC lands on these issues, the agency is "squarely into the period where staff will start putting pen to paper" now that comments are in.

While it's possible the agency would reopen the comment period — which would be the second time, after a May extension — Wolfe says that's not likely and that he expects a final rule to appear by the end of the year.

Ultimately, the rule will give the SEC more power to put its environmental, social and governance task

force to work. The task force, established in March 2021, netted its first fine this May.

The final rule "would give them a lot more to sink their teeth into," Wolfe said.

SEC's In-House Courts in Peril

The Biden administration earlier this month asked the full Fifth Circuit to review a May panel ruling that the agency's in-house court system is unconstitutional.

In the case of *Jarkesy v. SEC*, a hedge fund manager claimed that the agency's in-house adjudication violated his Seventh Amendment rights to a jury trial. The court agreed, throwing out a fine and other penalties imposed against the manager.

The ruling followed years of assertions that the SEC's court system enjoys an unfair home-court advantage by relying on the judgment of its own administrative law judges instead of juries.

The Supreme Court has agreed to consider similar cases and may ultimately review the Fifth Circuit's decision, which would have implications not only for the SEC but also for all government agencies that use administrative proceedings to mete out monetary penalties.

"If the Seventh Amendment ruling in *Jarkesy* stands, which is an 'if,' a number of agencies might face a cloud over their ability to use money penalties to enforce their rules, regulations and statutes in administrative proceedings," said Daniel Walfish, a partner at Walfish & Fissell PLLC and former senior counsel in the SEC's Enforcement Division.

"To avoid those issues, those agencies presumably would have to bring cases in court if they are authorized to do so, and if not, they would probably have to rely solely on other forms of relief, such as 'equitable' remedies, as opposed to fines," he said.

In a case already before the high court, the Fifth Circuit in December held in *SEC v. Cochran* that an accountant sanctioned by the agency could challenge the constitutionality of the in-house judges in district court. Investor Mark Cuban and hedge fund manager Nelson Obus were among those who signed on to an amicus brief this month backing Cochran.

The Supreme Court will hear the Cochran matter next term along with a consolidated case involving Axon Enterprise Inc., which is challenging the Federal Trade Commission's in-house court system.

"If the Supreme Court sides with the private parties and against the agencies in these cases, it would make it easier across the board to raise collateral challenges to administrative enforcement proceedings," Walfish said. "It will be easier to simply march into district court and say that the very existence of an agency proceeding represents a constitutional violation."

A Dense Rulemaking Agenda

Gensler has inarguably set forth an ambitious list of rulemaking proposals, covering topics that are both contentious and complex, including climate risk, cybersecurity, safe harbor laws and the regulation of special purpose acquisition companies, or SPACs.

"No regulation can be static in a dynamic society," Gensler said upon the release of the agency's spring agenda, quoting the ex-president of the New York Stock Exchange and SEC alumnus Robert Birnbaum.

But some have criticized shorter comment periods imposed under Gensler, particularly amid a range of new proposals.

"If commenters think that a proposal's comment period will be only 30 or 60 days, they may not invest in gathering data or performing economic analysis for submission to the comment file," Peirce said last month in a statement following the release of the agenda.

Gensler has occasionally acknowledged the criticisms and extended comment periods. But Peirce urged the agency "to build in more reasonable comment periods" at the time the rules are proposed.

Scott Mascianica, a Holland & Knight LLP partner and former SEC assistant director for enforcement, said the agency is effectively asking swaths of market participants to go through "thousands of pages of proposed rules and respond to, or at least consider, hundreds of individual questions."

Mascianica said that the rules don't just impact the primary stakeholders the proposals are aimed at. For instance, SPAC proposals will affect underwriters, cyber rules will affect vendors, and climate risk rules have implications all through the value chain, he said.

And shorter comment periods could be counterproductive for the SEC itself, putting strain on agency resources, and potentially depriving staff from having enough time to thoughtfully sift through the opinions of commenters, Mascianica said.

"The real purpose behind this process is for participants to offer thoughts and concerns," Mascianica said. "For the commission to get the full picture, they need time to meaningfully take the input in and craft the rules appropriately."

--Editing by Brian Baresch and Alyssa Miller.