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Three Takeaways From Recent SEC Enforcement Case

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The Securities and Exchange Commission (SEC) just announced a settled enforcement matter involving a public company and its CFO. (AP File No. 3-21438) The case presents three important takeaways for companies and executives.

The Case

The SEC alleged that a company and its CFO overstated the number of paying subscribers in the first quarter of 2019, which allowed the company to hit a previously disclosed estimate. In part due to the transition to a new billing platform, the company's reported "paying subscriber" metric allegedly included more than 15,000 non-paying subscribers. The SEC claims that the number of paying subscribers was a key metric for the company, analysts, and shareholders. The SEC charged the company with negligence-based fraud and various reporting violations, and the CFO with causing the company's violations.

The SEC also claimed that a whistleblower repeatedly raised concerns internally with senior management regarding the paying subscribers overstatement. The company's management and Audit Committee allegedly decided not to take action, so the whistleblower then reported to the SEC. Months later the company terminated the whistleblower for cause. The SEC charged the company with whistleblower retaliation.

Finally, the SEC alleged that the company's separation agreements included a clause stating that the signers could report concerns to governmental authorities, but that they waived their right to any monetary recovery. The SEC charged the company with impeding whistleblowers from reporting to the SEC, since the SEC views its whistleblower bounty payment program as important to encouraging tips.

The SEC gave the company credit for its remedial action of proactively revising its separation agreements. The company and CFO both resolved the matter on a neither-admit-nor-deny basis. The SEC ordered the company to pay a $2 million civil penalty and the CFO was required to pay a $50,000 civil penalty.

Key Lessons

1. **Institute and Follow Disclosure Protocols – Even for Non-GAAP Metrics.**
    - Review the process used to compile and publicly report metrics. Ensure the procedures build in checks and

verification steps, in light of the company's size.

- The SEC will focus on any important metric reported publicly, so the process should be followed for key non-GAAP metrics as well as GAAP financial results.
- Use a collaborative process involving key stakeholders to ensure unbiased results, particularly if a disclosure may involve suboptimal news (*e.g.,* technical glitches, missing a projection).

2. **Thoroughly Investigate and Address Internal Whistleblower Reports.**
    - Consider engaging outside counsel to appropriately investigate internal whistleblower reports and help design appropriate and prompt action addressing any real issues. Consider proactive remediation and possible self-reporting to earn cooperation credit (as appropriate for the matter). Investigations need not break the bank – experienced and cost-effective counsel can help craft a well-designed, reliable investigation.
    - Tread carefully when making employment determinations about whistleblowers. In addition to SEC charges, discharged individuals may claim retaliation under Sarbanes-Oxley and Dodd-Frank Acts, which provide employee-friendly standards.
    - Good employment hygiene is key. Well-documented regular employment evaluations help establish a clear historical performance track record for compensation, promotion, and termination determinations.
3. **Review Separation Agreements ASAP.**
    - Make certain separation agreements are in compliance with all state and federal laws. The SEC has brought prior whistleblower impeding charges based on separation agreements, akin to the above case. It is not a difficult charge for the SEC to assert, and that issue increases the likelihood of SEC enforcement action when coupled with other claimed issues.

In sum, undertaking some proactive measures might reduce the probability and severity of certain SEC enforcement charges. And when potential issues are reported, it is critical that companies and executives take appropriate and deliberate action to cost-effectively investigate and address any concerns.

Brian Neil Hoffman, a partner of Holland & Hart LLP, is a former SEC Enforcement counsel who represents companies and executives in SEC investigations and litigation, investigating whistleblower reports, and defending retaliation claims.

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