
CRAVATH, SWAINE & MOORE LLP

COVID-19: Initial Insights and Expectations for Government Enforcement

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What Are We Seeing and Hearing?

- **DOJ, SEC and other federal and state enforcement agencies remain active and are working remotely on non-COVID-19 criminal and regulatory matters, as well as on anti-fraud and other enforcement priorities emerging in response to the pandemic**
- **Exams by SEC Office of Compliance Inspections and Examinations (OCIE) of regulated entities are continuing and focusing on business continuity planning related to COVID-19**
- **Enforcement agencies continue to engage with companies on the progress of internal investigations, schedule and receive company presentations by telephone and video conference, review submissions and engage in settlement discussions**
- **FCPA and other investigations continue but pace is slowing. Impact of COVID-19 on other jurisdictions, such as England, France and Germany, in cross-border investigations is also impeding tempo**
- **Trial preparation in white collar cases is inhibited, as travel is limited and witness preparation is affected by COVID-19 response, and federal courts across the country have postponed trial dates and related filing deadlines**
- **Monitorships are impacted as some monitored companies curtail business and physical site visits are delayed**

Overview of COVID-19 Impact on Government Enforcement

▪ SEC

- Committing substantial resources to combatting insider trading, selective disclosures, inaccurate accounting and market manipulation related to COVID-19
- Regular coordination with U.S. and foreign financial regulatory community
- COVID-19 presents unique circumstances for evaluating compliance with the disclosure, accounting and antifraud provisions of the securities laws
- Evaluating the effects of COVID-19 in risk factors, MD&A, accounting and earnings guidance
- Considering growing risk of selective disclosures and non-compliance with Regulation FD
- SEC Enforcement has historically examined accounting, disclosures and trading following significant unanticipated events, such as natural disasters and precipitous market activity; we anticipate the same will happen with COVID-19

▪ DOJ

- Prioritizing the investigation and prosecution of fraud, cybercrime, hoarding and price gouging related to COVID-19, as well as the enforcement of antitrust laws in connection with the manufacturing, distribution or sale of public health-related products and services
- Criminal trials, filing deadlines and Speedy Trial Act suspended or postponed in many key districts
- COVID-19 containment measures are slowing down enforcement, potentially creating statute of limitations-related challenges for the government in some matters

Overview of COVID-19 Impact on Government Enforcement

▪ Other Federal and State Enforcement Agencies

- CFTC
 - Extensions of filing deadlines for certain Commodity Pool Operators (CPOs), Commodity Trading Advisors (CTAs) and Foreign Brokers affected by COVID-19
 - Committing resources to policing fraudulent activity in commodities markets in connection with recent market volatility
- FinCEN
 - Encourages financial institutions to communicate concerns related to timely filing of Bank Secrecy Act (BSA) reports
 - Suspended certain Commodities Trading Report (CTR) filing obligations
- NYDFS
 - Required regulated financial institutions to submit preparedness plans for managing operational disruptions
 - Announced temporary relief for regulated entities from certain requirements of the New York Banking Law and Financial Services Law, including certification of compliance with cybersecurity requirements
- State AGs
 - Primarily focused on combatting price gouging, fraud schemes and other forms of misconduct targeted at consumers
 - Trials delayed (*e.g.*, New York AG's opioid suit)
- PCAOB
 - Audit firms given 45-day relief period from inspections
 - Certain engagements must still provide access to audit documentation
 - Stressed the importance of adhering to PCAOB standards since “investors depend now, more than ever, on the integrity of financial statements”
- OFAC
 - No changes announced to date in response to COVID-19

COVID-19 and SEC

Key Statements and Actions

▪ February 19 Statement (Chairman Jay Clayton)

- Provided examples of U.S.-listed companies whose disclosure obligations may be affected by COVID-19, including (i) companies with “significant operations” in affected jurisdictions and (ii) companies that depend on companies that operate in affected jurisdictions
- He also “urge[d] issuers to work with their audit committees and auditors to ensure that their financial reporting, auditing and review processes are as robust as practicable in light of the circumstances in meeting the applicable requirements”

▪ March 4 Commission Order

- Granted reporting companies, subject to certain conditions, an additional 45 days to make certain Exchange Act filings otherwise due between March 1 and April 30
- Encouraged companies to (i) avoid selective disclosures related to the impact of COVID-19; and (ii) “refrain from securities transactions with the public” and “take steps to prevent directors and officers . . . from initiating such transactions” where companies have become aware of COVID-19 risks
- Encouraged companies to (i) “provide investors with insight regarding their assessment of, and plans for addressing, material risks to their business and operations resulting from [COVID-19] to the fullest extent practicable”; and (ii) “avail themselves of the safe harbor in Section 21E of the Exchange Act for forward-looking statements”

▪ March 23 Statement (Enforcement Division)

- Noted risk of insider trading: “In these dynamic circumstances, corporate insiders are regularly learning new material nonpublic information that may hold an even greater value than under normal circumstances. This may particularly be the case if earnings reports or required SEC disclosure filings are delayed due to COVID-19. Given these unique circumstances, a greater number of people may have access to material nonpublic information than in less challenging times”
- Underscored commitment to “ensuring that our Main Street investors are not victims of fraud or illegal practices in these unprecedented market and economic conditions”

Key Statements and Actions

▪ **March 25 Commission Order**

- Supersedes and extends the March 4 Commission Order to provide, subject to certain conditions, an additional 45 days to make certain Exchange Act filings otherwise due between March 1 and July 1 (as opposed to April 30)

▪ **March 25 Statement (Corporate Finance Division)**

- Provided guidance regarding COVID-19-related disclosures, including several questions intended to help companies assess and disclose the evolving impact of the pandemic
 - Recommended questions encourage companies to conduct a fact-based analysis with respect to COVID-19's impact on operations and financial conditions, liquidity, balance sheets, accounting judgments, internal controls, business continuity, demand for products and services, supply chain functionality, human capital resources and travel restrictions

▪ **April 3 Statement (Office of the Chief Accountant)**

- Stated that OCA will view companies that temporarily elect to defer or suspend certain GAAP provisions pursuant to the Coronavirus Aid Relief and Economic Security Act (CARES) Act as complying with GAAP for the periods for which such elections are available
- Discussed the role of judgments and estimates in financial reporting and noted the heightened challenges associated with those issues in the current environment of uncertainty
- Stressed the continuing importance of making “well-reasoned judgments”

COVID-19 and Periodic Disclosure Issues

▪ Risk Factors

- Companies are required to disclose COVID-19 risks in the “Risk Factor” sections of annual reports on Forms 10-K
 - Quarterly reports on Form 10-Q need to include any material updates
- In light of the unprecedented uncertainty regarding the degree of business and market disruption, it may be appropriate to make risk factor disclosures more robust
- Disclosure of specific facts about the past and the likely future effect of COVID-19 is preferable to general observations about what impact those issues may or may not have in the future or more generally on the economy
 - The SEC has made it very clear that a company should not speak in generalities or about hypotheticals if it has already experienced a specific event or risk
- Accordingly, companies should closely review their operations in geographic areas particularly affected by COVID-19 and/or its effect on supply chains, labor, customer demand and logistical considerations involving those areas

▪ MD&A

- When filing reports on Forms 10-K and 10-Q, companies must comply with Rule 303 of Regulation S-K, which requires disclosure “of known trends or uncertainties that have had or that the [company] reasonably expects to have a material favorable or unfavorable impact on net sales or revenues”
- To the extent COVID-19, or the implementation of COVID-19-related contingency plans, has had an impact on a company’s business and results by the time the company is filing its next periodic report, the impact should be discussed in sufficient detail in the MD&A section

COVID-19 and Earnings Guidance Issues

- **Whether existing earnings guidance has been overtaken by events related to COVID-19 is an extremely fact-specific question**
- **Cravath has published materials entitled “COVID-19: Earnings Guidance Implications” with more information on how companies should approach questions related to the effect of the COVID-19 pandemic on past and future earnings guidance**

Anticipated Enforcement Priorities

▪ **Trading in company securities**

- Various circumstances may cause a company to consider disclosures relating to the impact of the COVID-19 pandemic prior to its next earnings release or periodic report, including if it wants to buy or sell its own securities
- Similarly, if a company becomes aware of COVID-19 related information that could be deemed to be material to investors, it should consider whether to keep trading windows closed prior to disclosure of information to investors
- Companies and their directors and officers should review their securities trading policies and consider whether trading windows should remain closed unless their public disclosure reflects all material facts about the impact of COVID-19 on the company

▪ **Insider trading**

- As highlighted in the Enforcement Division's March 23 statement, the SEC is committing substantial resources to policing insider trading
- We anticipate SEC scrutiny of trading activity by management and board members as the impact of COVID-19 begins to emerge

▪ **Accounting judgments and estimates**

- Historically, changes in accounting judgments and estimates following significant unanticipated market events have drawn investigative scrutiny, and we anticipate the same will happen with COVID-19
- As highlighted in the Office of the Chief Accountant's April 4 statement, the SEC seeks to ensure that COVID-19 does not diminish the quality of companies' financial reporting
- Companies that modify their accounting judgments or estimates in light of COVID-19 should ensure that there is a reasonable basis for the modification and contemporaneously document that basis

Anticipated Enforcement Priorities

▪ **Selective disclosures / Regulation FD**

- Crises and uncertainty present unique incentives for the investment community to seek an information “edge”
- As highlighted by the SEC in its March 4 statement, “[w]hen companies do disclose material information related to the impacts of the coronavirus, they are reminded to take the necessary steps to avoid selective disclosures and to disseminate such information broadly”
- This cautionary note regarding ensuring continued compliance with Regulation FD will also apply to material non-public information concerning financial results, business impacts, guidance and other material issues
- Companies must therefore continue to be vigilant on Regulation FD issues through training, coordination and approval of communications

▪ **Market manipulation**

- Extreme market volatility creates opportunities for market manipulation in a company’s securities, which we have successfully helped corporate issuers manage with the SEC
- The SEC has already taken quick steps to shut down suspicious trading activity related to COVID-19’s impact on business operations
 - In February, the SEC suspended trading in the stock of two companies—Aethlon Medical, Inc. and Eastgate Biotech Corp.—due to concerns about the accuracy of COVID-19-related information released by third-party stock promoters
- We anticipate that the SEC will mount an aggressive enforcement response to curtail market manipulation in connection with COVID-19
 - Following Hurricane Katrina, the SEC brought a number of enforcement actions against individuals and companies that engaged in “pump and dump” schemes and investment scams targeted at individuals receiving compensation from insurance companies

COVID-19 and DOJ

Key Statements and Actions

- **March 9 Statement (Office of the Attorney General)**

- Announced DOJ's intention to hold accountable anyone who violates antitrust laws in connection with the manufacturing, distribution, or sale of public health-related products such as face masks, respirators and diagnostics

- **March 16 Statement (Attorney General)**

- A.G. Barr directed all U.S. Attorneys to prioritize the investigation and prosecution of wrongdoers seeking to profit from the COVID-19 pandemic (the "A.G. Directive")

- **March 19 Statement (Office of the Deputy Attorney General)**

- Deputy A.G. Rosen issued a memorandum directing each U.S. Attorney to appoint a Coronavirus Fraud Coordinator on matters relating to the prosecution of crimes related to the pandemic and to conduct outreach and awareness

- **March 22 Civil Action (Western District of Texas)**

- First action filed by the DOJ's Civil Division to address fraud related to COVID-19; alleges that the operators of the website "coronavirusmedialkit.com" charged consumers for purported vaccine kits that do not exist

- **March 24 Statement (Antitrust Division)**

- Provided guidance for companies considering procompetitive collaboration in connection with the COVID-19 response

- **March 24 Statement (Office of the Attorney General)**

- Announced the creation of the COVID-19 Hoarding and Price Gouging Task Force to combat COVID-19-related market manipulation, hoarding and price gouging

Anticipated Enforcement Priorities

▪ Antitrust laws

- As highlighted in its March 24 statement, the DOJ is prioritizing enforcement of criminal and civil antitrust laws in connection with the manufacturing, distribution and sale of public health-related products and services, including anticompetitive agreements regarding:
 - Pricing for competing products and services
 - Determination of which products and services will be offered (or not offered) to customers (*e.g.*, agreements that all competing businesses within a geographic area will close temporarily)
 - Allocation of consumers of products and services between competitors
 - Pay and benefits offered to employees whose work schedules are affected by containment measures
- The DOJ's Procurement Collusion Strike Force—created in November 2019 to coordinate a national response to combatting antitrust crimes and related schemes in government procurement—may also be used to address collusive practices in the sale of public health products to government agencies
- Businesses engaged in public health-related industries should expect close scrutiny from the DOJ of what may be viewed as anticompetitive agreements, particularly if such conduct relates to the COVID-19 response or otherwise exploits vulnerable workers or consumers

▪ Consumer fraud and cybercrime

- Pursuant to the A.G. Directive, U.S. Attorney's Offices can be expected to prioritize prosecution of COVID-19-related fraud schemes and cybercrimes such as ransomware attacks and phishing schemes, which seek to exploit vulnerabilities arising from efforts by businesses to respond and adapt to the pandemic
- Key U.S. Attorney's Offices, including in New York, Washington, D.C., California, Illinois and Florida, have already issued statements announcing the implementation of the AG Directive

Anticipated Enforcement Priorities

- **Compliance with CARES Act**

- The CARES Act establishes several oversight bodies to review corporate conduct and ensure the integrity of the process by which COVID-19 relief funds are disbursed, including
 - Pandemic Response Accountability Committee (armed with subpoena power and staffed by the Inspectors General of other agencies)
 - Congressional Oversight Commission
 - Special Inspector General for Pandemic Recovery
- We expect that the DOJ will work with these bodies to review the conduct of companies that have received COVID-19 relief funds

COVID-19 and Delays in DOJ Enforcement

▪ Trials

- Criminal and civil trials and related filing deadlines have either been suspended indefinitely or postponed for several weeks in federal district courts across the country
 - On March 16, the Southern and Eastern Districts of New York issued administrative orders that continued indefinitely all criminal (and civil) trials scheduled to begin before April 27
 - Pursuant to these orders: (i) compliance with all trial-specific deadlines in criminal and civil cases scheduled to begin before April 27 is at the discretion of the trial judge; and (ii) the time between March 16 and April 27 is excluded under the Speedy Trial Act in all criminal matters

▪ Investigations

- Aspects of prosecutions and investigations will continue relatively unimpeded
 - The U.S. Attorney's Office in Manhattan will permit grand juries to convene virtually via videoconference
- However, there will be inevitable delays in the progress of investigations due to travel restrictions, shelter-in-place orders, prohibitions on in-person meetings and other efforts intended to slow the spread of COVID-19
- Companies that have received government subpoenas for documents will likely be delayed in their ability to reply due to these same containment efforts
- Depending on the length of these delays, it is possible that the government will face obstacles in complying with the 5-year statute of limitations period that governs most federal offenses
 - We anticipate an increased effort by the DOJ to use tolling agreements with companies and individuals; the DOJ may also seek a legislative fix from Congress

COVID-19 and Other Enforcement Agencies

CFTC

▪ Key Statements and Actions

- March 18 Customer Advisory
 - Cautioned public to be on alert for increased fraudulent activity during the COVID-19 pandemic
- March 23 No-Action Relief
 - Permitted National Futures Association member CPOs and CTAs to furnish Form CPO-PQR, NFA Form PQR and Form PR, annual reports and periodic account statements on a delayed basis
 - Division of Swap Dealer and Intermediary Oversight will also consider additional or different forms of regulatory relief for registered CPOs on a case-by-case basis
- March 30 No-Action Position
 - Subject to certain conditions, recommended no action be taken until September 30 against a Foreign Broker for failing to register as an Introducing Broker

▪ Anticipated Enforcement Priorities

- Fraud schemes targeted at investors' desire to recoup losses or seek safety in the wake of recent market volatility

FinCEN

▪ Key Statements and Actions

- March 16 Guidance
 - Requested that financial institutions affected by COVID-19 communicate concerns related to their ability to file timely reports required under the BSA, including Suspicious Activity Reports and Currency Transaction Reports
 - Flagged several trends with respect to malicious or fraudulent transactions that have emerged since the onset of the COVID-19 pandemic
 - Encouraged financial institutions that observe suspicious transactions that could be associated with COVID-19 to check the applicable boxes in the Suspicious Activity Report template and to enter “COVID-19” in Field 2 of the template
- April 3 Guidance
 - Suspended until further notice certain CTR filing obligations under the BSA where reporting transactions involve sole proprietorships and entities operating under a “doing business as” name

▪ Anticipated Enforcement Priorities

- Fraud schemes such as “imposter scams”, “investment scams” and “product scams”, as well as insider trading

NYDFS

▪ Key Statements and Actions

- March 10 Guidance
 - Required regulated financial institutions to submit preparedness plans for managing operational disruptions within 30 days (April 9)
- March 12 Order
 - Granted relief to regulated entities affected by COVID-19:
 - Temporary Relocations or Closures
 - Regulated entities may temporarily relocate any of their authorized places of business or close any of their branch offices or locations without complying with the prior notice or application requirements of the New York Banking and Financial Services Laws, provided that the regulated entity submits prompt written notice to the Superintendent
 - Filing Deadline Extensions
 - 45-day extension of the due date for certain filings from regulated entities that are unable to meet the original due date because of the COVID-19 pandemic, including certifications of compliance with cybersecurity requirements, Annual Reports and Comparative Statements and Volume of Operation Reports
 - In-Person Presence at Board Meetings
 - Regulated entities may use telephone, video-conferencing or similar electronic means to satisfy the in-person participation requirement

▪ Anticipated Enforcement Priorities

- At this time we do not anticipate material changes to NYDFS's enforcement priorities

OFAC

- **Key Statements and Actions**

- OFAC has not modified existing regulations or created new licenses in response to COVID-19

- **Anticipated Enforcement Priorities**

- At this time we do not anticipate material changes to OFAC's enforcement priorities
- Companies should assume continuation of the status quo with respect to sanctions enforcement

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