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Day Pitney White Collar Roundup – April 2023 Edition

Influencers May Be All the Rage These Days, but Not These Ones

The Department of Justice (DOJ) recently announced that a federal grand jury in Florida returned a superseding indictment that charged three Russian nationals and four U.S. citizens with working on behalf of the Russian government, and in particular the Russian Federal Security Service (FSB), to conduct a foreign malign influence campaign here for several years. Such campaigns represent hostile efforts by or on behalf of certain foreign governments to influence the policies or activities of the U.S. or state or local governments, including elections, or U.S. public opinion. Aleksandr Ionov, a resident of Moscow and founder of an entity styled the Anti-Globalization Movement of Russia, allegedly used the group to carry out the influence campaign. According to the DOJ, Ionov has allegedly been executing this campaign since at least 2014. More recently, the influence campaign is said to have continued through Russia's invasion of Ukraine and included multiple statements of solidarity with the Russian government. According to a separate release by the U.S. Department of the Treasury, Ionov is an FSB co-optee who uses his position to support organizations that he believes will create sociopolitical disruptions in the United States. In conjunction with the original indictment, the Treasury had added Ionov to its Specially Designated Nationals and Blocked Persons List, thereby blocking his assets. The superseding indictment further alleges that the defendants conspired to influence democratic elections in the United States by recruiting members of U.S. political groups to promote Russian propaganda relating to Russia's invasion of Ukraine. These alleged efforts included funding the 2019 political campaign of a candidate for local office in Florida. This, unfortunately, is not a unique case. In its recent announcement, the DOJ discussed a similar case in the District of Columbia that charged another Russian national with conspiracy to recruit U.S. citizens from academic and research institutions to participate in a Russian diplomacy program. The affidavit in support of that criminal complaint alleges that an FSB officer funded the diplomacy program and the conspiring parties used it to promote Russian national interests. The Russian security service's support and funding were not disclosed. As we have previously reported, last year the DOJ also charged a senior Russian legislator with unlawfully influencing U.S. foreign policy, notably including with respect to Ukraine. In the recent announcement, Assistant Attorney General Matthew G. Olsen made it clear that the DOJ is committed to prosecuting perpetrators of campaigns that jeopardize First Amendment rights and seek to corrupt U.S. elections in service of foreign interests. In this way, the government plans to wield its own considerable influence to shut down future foreign malign influencers.

It Ain't Over Till It's Over, Except for Challenges to SEC Proceedings

In April, the U.S. Supreme Court held that federal district courts have jurisdiction to consider claims challenging the constitutionality of *ongoing* administrative proceedings with the Securities and Exchange Commission (SEC) and Federal Trade Commission (FTC). Justice Elena Kagan authored the unanimous decision in *Axon v. FTC*, which was consolidated with *SEC v. Cochran*. In both cases, respondents had filed challenges to ongoing administrative proceedings in the district courts and pursued them to the Supreme Court. Our article focuses on Cochran's journey and the implications of her case. The *SEC v. Cochran* case arose from a 2016 administrative proceeding against Michelle Cochran, a certified public accountant, who the SEC claimed violated federal auditing standards. An SEC administrative law judge (ALJ) found that Cochran had violated the Securities Exchange Act of 1934. The ALJ banned Cochran from practicing accounting for five years and imposed a $22,500 civil penalty. Following the SEC's adoption of this decision, Cochran objected. However, before the SEC had the opportunity to rule on Cochran's objection, the Supreme Court issued its opinion in *Lucia v. SEC* opinion, holding that ALJs with the SEC were officers of the United States under the Appointments Clause and thus were required to

be appointed by the president, a court of law or a department head, rather than hired by the administrative agency. As a result, the SEC determined that all pending enforcement proceedings, including Cochran's case, would be vacated and tried before new ALJs. In 2019, while her second enforcement action was pending, Cochran filed suit against the SEC in federal district court alleging that the "for cause" removal protections enjoyed by the now-appointed SEC ALJs violated Article II of the Constitution. In 2021, the U.S. Court of Appeals for the 5th Circuit, en banc, ruled that Cochran could assert constitutional challenges to her ongoing administrative proceeding. The SEC appealed to the Supreme Court, which forced the Court to grapple with the important jurisdictional question: Do federal courts have jurisdiction to hear challenges to ongoing administrative proceedings? The Court's answer, unanimously, is that they do. In reaching this conclusion, the Court had to ascertain whether the claims were of the type Congress intended to be reviewed within the statutory structure of the Exchange Act (or in the case of *Axon*, the FTC Act), which would have precluded district court jurisdiction. The Court applied the factors it had previously articulated in the *Thunder Basin* case to its analysis of the statutory review scheme. First, the Court confirmed that the seemingly abstract injury at issue in the case is a "here-and-now injury" that cannot be remedied after the fact, and therefore all meaningful judicial review of the claim would be foreclosed if jurisdiction was precluded. Second, the Court confirmed that constitutional challenges are wholly collateral to the types of claims regularly adjudicated by the agencies and thus outside of the commission's expertise. While the full impact of the decision remains pending, the potential implications may be significant. For example, Justice Clarence Thomas, in his concurring opinion, cast doubt on the constitutionality of Congress vesting administrative agencies with primary authority to adjudicate core private rights with limited deferential judicial review. If Thomas intended to encourage the future consideration of that issue, that future may not be that far off, given the pendency of the government's petition for certiorari in another SEC case, *SEC v. Jarkesy*. In *Jarkesy*, an investment adviser sought to enjoin SEC proceedings against him, alleging violations of several constitutional rights, including the right to a jury trial, the delegation of power to the SEC and restrictions on the removal of ALJs. If certiorari is granted in *Jarkesy*, the Court will adjudicate further challenges to the constitutionality of the SEC's administrative process. Either way, however, the district courts are almost certain to see an uptick in other challenges to agency proceedings.

It Ain't Over Till It's Over, Including Due Process Claims

Also in April, the U.S. Supreme Court addressed an entirely different question concerning the timing of underlying proceedings on the federal courts' jurisdiction to entertain claims. In *Reed v. Goertz*, the issue concerned the timeliness of claims under 42 U.S.C. § 1983 for alleged due process violations arising from state post-conviction DNA testing procedures. In a 6-3 majority opinion authored by Justice Brett Kavanaugh, the Court held the limitations period for such claims begins to run only after the state post-conviction process is truly and fully complete. In 2014, Rodney Reed, who is incarcerated in Texas for murder in a capital punishment case, moved under the state's post-conviction DNA testing law to compel DNA testing on more than 40 pieces of evidence, arguing that such testing would identify the true perpetrator of the crime. The Texas state trial court denied the motion, including on the basis that many of the items Reed sought to test had not been preserved through an adequate chain of custody as required under the statute. The trial court's decision was affirmed on appeal by the Texas appellate court, and Reed's further motion for rehearing was also denied. Reed then challenged the decision in U.S. district court. He found little success there either. The district court held that Reed's Section 1983 suit was time-barred, and the U.S. Court of Appeals for the 5th Circuit agreed, holding that the two-year limitations period had begun to run when the state trial court first denied Reed's original motion. The Supreme Court disagreed. It reasoned that for the constitutional claim at issue (procedural due process), precedent made clear that the claim is complete only when the state at issue has failed to provide the petitioner with due process. In Texas, the process for seeking DNA testing includes both trial court proceedings and appellate review, which, the Court further found under state rules of appellate procedure, also encompassed Reed's motion for rehearing. Thus, the limitations period for Reed's claim only began to run when the Texas appellate court later denied his motion for rehearing. The Court reversed the 5th Circuit and held that Reed's Section 1983 claim was timely. Given the decision's conclusion in extending the timeliness of Reed's challenge, and at least permitting his underlying argument about the constitutionality of the Texas statute's chain of custody limitations on DNA testing to proceed, some may have been surprised to see Kavanaugh's byline. Moreover, the decision may have repercussions beyond Texas, in other states that provide for post-conviction DNA testing. It may have repercussions beyond the issue of DNA testing itself, in the timeliness of challenges to other forms of state post-conviction criminal procedure. Time will tell, as they say, about the full impact of the Court's decisions on timeliness.

Peekaboo! PCAOB Sees Your SPAC Audit Issues

The pandemic era brought with it a rush of special purpose acquisition company (SPAC) transactions, along with warnings from the Securities and Exchange Commission about poor disclosure and investor protection practices, as we've noted previously. Although the market for *new* SPACs has cooled, recent revelations from a key regulator suggest that the many SPACs already in the pipeline can expect ongoing scrutiny. In a recent report, the Public Company Accounting Oversight Board (PCAOB), sometimes pronounced in colloquial conversation as "peekaboo," noted that its inspections of more than 100 SPAC-related U.S. public company audits performed in 2021 and 2022 found significant deficiencies. Specifically, more than 60 percent of the SPAC-related audits it examined from 2021 had at least one deficiency, as did close to 40 percent of the SPAC-related audits it examined from 2022. The deficiencies included weaknesses in internal controls, incomplete audit sampling techniques, insufficient communications between auditors and audit committees, and failures in identifying material misstatements due to errors in accounting for derivatives. The PCAOB observed that the deficiencies, particularly weaknesses in internal controls over financial reporting, were pervasive due to company management's lack of experience. The report presents some key recommendations for auditors:

- Exercise due professional care and professional skepticism.
- Consider whether presentation and disclosures in the financial statements conform with Generally Accepted Accounting Principles (GAAP).
- Understand the public company's processes to develop its accounting estimates.
- Remain alert to changes in the company's or the auditor's circumstances giving rise to situations that could impair auditor independence.

Unsurprisingly, with the noted audit deficiencies—and with so many SPACs still looking for a merger partner—SPACs will continue to be under a regulatory spotlight in 2023. Indeed, the PCAOB's recently released staff priorities for the year ahead indicate de-SPAC transactions and the "trend of deal cancellations and redemptions" related to SPACs are among the top priorities for inspections going forward. SPAC managers, auditors and other professionals involved with SPACs would be wise to shore up their financial reporting and audit practices, lest the practice of "peekaboo" turns into a game of "gotcha."

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