GIBSON DUNN

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PCAOB Conducts Final Rulemaking of Biden Administration

The PCAOB continued its broad and active approach to rulemaking in recent months as the 2024 elections loomed, with multiple new standards and amendments being approved by the PCAOB and then the SEC:

- AS 1000, *General Responsibilities of the Auditor in Conducting an Audit*, replaces four auditing standards that previously set forth general principles and responsibilities of auditors: AS 1001, *Responsibilities and Functions of the Independent Auditor*; AS 1005, *Independence*; AS 1010, *Training and Proficiency of the Independent Auditor*; and AS 1015, *Due Professional Care in the Performance of Work*. The new AS 1000 provides an updated, comprehensive standard to govern auditing principles, including a clarification of the auditor's responsibility to evaluate whether financial statements are "presented fairly"; clarification of the engagement partners' responsibilities regarding certain performance standards; and an accelerated schedule for finalizing audit documentation.

- QC 1000, *A Firm's System of Quality Control*, is an integrated, risk-based standard that mandates quality objectives and key processes for quality control systems, in the PCAOB's first comprehensive revision of quality control standards since its founding. Updates in QC 1000 include emphasizing culture and "tone at the top"; balancing risk-based and mandated processes; addressing changes related to technology and firm networks; broadening responsibilities for monitoring and remediation; and requiring an annual evaluation of the firm's QC system.

- Rule 3502, *Responsibility Not to Contribute to Violations*, was amended to lower the standard for contributory liability of associated persons for registered firm violations, from recklessness to negligence. Under the new version of the rule, an associated person must not contribute to a firm's violation "by an act or omission that the person knew or should have known would contribute to such violation." The PCAOB considered a revision that would have expanded liability to include associated persons of any firm contributing to a firm's violation, but concluded that it was unnecessary.

- The PCAOB adopted, and the SEC is considering, an amendment to Rule 2107 to permit the SEC to treat a registered firm's delinquency in filing an annual report and paying an annual fee as a constructive request to withdraw from registration.

- AS 1105, *Audit Evidence* and AS 2301, *The Auditor's Response to Risks of Material Misstatement*, were amended to clarify the auditor's responsibility when using analytical tools in conducting audits.

- On November 21, the PCAOB adopted rules relating to Firm Reporting and Firm and Engagement Metrics, expanding the breadth of information that must be reported to the PCAOB, and in many cases to the public, on Forms 2, 3, and QC, as well as a new Forms QCPP and FM.

It was reported in November that the PCAOB had shelved its proposal to update the illegal act auditing standard with a broader standard covering noncompliance with laws and regulations (NOCLAR).

Plaintiff Challenges Venue Transfer of PCAOB Litigation

On August 22, 2024, the U.S. District Court for the Southern District of Texas transferred to D.C. federal court one of the pending actions (by "John Doe Corporation") challenging the constitutionality of the PCAOB and its investigative procedures. After the plaintiff challenged the transfer in the D.C. forum, Judge James Boasberg denied the plaintiff's motion to stay the proceedings while the challenge is pending; in response, on September 12, 2024, the plaintiff filed a writ of mandamus with the U.S. Court of Appeals for the Fifth Circuit, arguing that the Texas district court abused its discretion by transferring the case to D.C. Meanwhile, in the D.C. forum, the PCAOB moved on September 20 to dismiss the amended complaint. The appeal and motion are still pending.

Eighth Circuit Sees Influx of Briefs in SEC Climate Rule Litigation

Dozens of briefs were filed in the U.S. Court of Appeals for the Eighth Circuit between June 14 and September 17, 2024, as petitioners and the SEC litigate the Commission's rules requiring registrants to provide certain climate-related disclosures. Briefs were filed by the petitioners challenging the SEC's rules, including the U.S. Chamber of Commerce, the Texas Association of Business, the Longview Chamber of Commerce, Liberty Energy, Inc., the Texas Alliance of Energy Producers, the National Legal & Policy Center, the National Center for Public Policy Research, and dozens of states. Petitioners and intervenors raised numerous arguments, including that the rules are irrational, diverge from SEC precedent, exceed the SEC's statutory authority, and violate the First Amendment. Oral argument has not yet been scheduled. The SEC and other intervenors also filed briefs defending the rules.

Recent Court Rulings on Attorney Proffers and Their Implications

Recent court rulings in high-profile cases such as *United States v. Menendez* and *United States v. Coburn* have highlighted significant legal implications regarding the admissibility of attorney proffers in criminal trials. In *Menendez*, the court admitted a PowerPoint presentation created by Senator Bob Menendez's counsel, and shown to prosecutors, as part of an attorney proffer. The PowerPoint was later used to support obstruction charges against Senator Menendez on the grounds that he caused his counsel to make false and misleading statements in the presentation. While the *Menendez* case was unique in many ways, at least one unreported case from the Southern District of New York suggests *Menendez* was not the first time the government has charged a defendant with obstruction based on an attorney proffer. The *Menendez* case underscores the need for defense counsel to exercise caution when making attorney proffers.

In *Coburn*, the court upheld a defense subpoena seeking trial testimony from a law firm that conducted an internal investigation into alleged Foreign Corrupt Practices Act (FCPA) violations. The ruling emphasized that presenting information from internal investigations to prosecutors can waive attorney-client privilege, making it accessible for use in subsequent litigation. The court allowed the defense to elicit testimony from the law firm regarding the investigation, provided it was limited to information already disclosed to the government. The *Coburn* case illustrates the importance of understanding the scope of admissible evidence during the pendency of an investigation.

Federal Court Vacates FTC's Non-Compete Rule

On August 20, 2024, the U.S. District Court for the Northern District of Texas set aside the FTC's Non-Compete Rule that would have retroactively invalidated over 30 million employment contracts and preempted the laws of 46 states. The court held that (1) the Rule exceeded the FTC's statutory authority because the FTC does not have authority to promulgate substantive rules regarding unfair methods of competition, and (2) the Rule is arbitrary and capricious, in violation of the Administrative Procedure Act (APA), because the FTC failed to justify the nearly universal breadth of its ban.

The FTC filed a notice of appeal on October 18, 2024. In the meantime, the district court's order stands with nationwide effect, meaning that the FTC cannot enforce the Non-Compete Rule against any party, existing non-compete agreements remain enforceable, and new agreements can be executed.

Gibson Dunn represented Ryan, LLC, the first party to challenge the lawfulness of the Non-Compete Rule. A group of trade associations led by the United States Chamber of Commerce intervened in the case to challenge the Rule as well. Please refer to Gibson Dunn's two prior client alerts (here and here) for more information.

DOJ Launches New Whistleblower Program

On August 1, 2024, the Department of Justice (DOJ) announced its new Corporate Whistleblower Awards Pilot Program. This three-year initiative, managed by DOJ's Criminal Division's Money Laundering and Asset Recovery Section (MLARS), aims to address gaps in existing whistleblower programs by targeting specific corporate and financial misconduct.

This program is limited to individuals, with awards granted at DOJ's discretion from the Asset Forfeiture Fund. Only forfeitures over $1 million qualify for awards. Whistleblowers must provide "original information" that is material and not previously known to prosecutors, relating to (1) money laundering and related crimes; (2) foreign and domestic corruption; (3) public corruption; or (4) health care fraud involving non-governmental entities. A whistleblower must not have significantly engaged in the alleged crime, or gained information as internal auditors or compliance officers. However, minimal participation in misconduct does not disqualify a whistleblower from receiving an award.

The Pilot Program overlaps with several other federal whistleblower programs; whistleblowers cannot recover under the Pilot Program if they can recover under another award program, and whistleblower awards under the Pilot Program are expected to be less than those available through various other whistleblower programs.

Further details on the program can be found our recent client alert. As the program evolves, Gibson Dunn will continue to monitor updates and provide guidance to corporations navigating this new regime.

California Supreme Court Issues Ruling on Arbitration Rights

On July 25, 2024, the California Supreme Court ruled in *Quach v. California Commerce Club* that the requirement to show prejudice is no longer necessary when determining if a party has waived its right to compel arbitration. This decision brings California in line with the U.S. Supreme Court's 2022 ruling in *Morgan v. Sundance, Inc*.

The California Supreme Court clarified that "under California law, as under federal law, a court should apply the same principles that apply to other contracts to determine whether the party seeking to enforce an arbitration agreement has waived its right to do so." Thus, in determining to enforce an arbitration agreement, the focus should be on whether the party's actions were inconsistent with the intent to arbitrate, rather than whether the opposing party was prejudiced by the delay.

Please refer to Gibson Dunn's client alert on the case for further details.

Texas Supreme Court Rejects Challenge to State Court Structure

On August 23, 2024, the Texas Supreme Court rejected a challenge to the constitutionality of the state's Fifteenth Court of Appeals.

The Texas Legislature created the Fifteenth Court of Appeals—an intermediate appellate court with exclusive, statewide jurisdiction over both appeals (1) involving the State, and (2) from Texas's newly created Business Court—in 2023. In March 2023, Dallas County and its sheriff sued the Texas Health and Human Services Commission over the agency's alleged failure to transfer inmates adjudicated incompetent to stand trial to state hospitals. The State appealed the denial of its jurisdictional challenge to the Third Court of Appeals. Seeking to block the transfer of the State's appeal to the Fifteenth Court, Dallas County filed a writ of injunction in the Texas Supreme Court, arguing that the Legislature's creation of the new court violated several provisions of the Texas Constitution. The court held that the Legislature's creation of a specialized court of appeals with exclusive, statewide jurisdiction was entirely consistent with the Texas Constitution's text and history.

The Fifteenth Court opened, as planned, on September 1, 2024, with a docket comprised of appeals of cases brought by or against the State and appeals from the Business Court. Further details can be found in our recent client alert.

Other Recent SEC and PCAOB Enforcement and Regulatory Developments

Enforcement

- In the third quarter, the SEC continued to pursue numerous enforcement actions—as part of its "sweep" strategy—related to failures to preserve electronic communications and violations of whistleblower protections based on agreements allegedly impeding employee reporting to the SEC. For example, on September 9, 2024, the SEC announced settled charges against seven public companies for violations of the whistleblower protection Rule 21F-17(a) related to employment, separation, and other agreements that, among other things, required employees to waive rights to any whistleblower awards. The public companies agreed to pay more than $3 million dollars in civil penalties. On August 14, 2024, the SEC also announced settled charges against 26 broker-dealers and investment advisors for widespread failures to preserve electronic communications, resulting in more than $390 million in civil penalties.

- In August 2024, the SEC quietly dismissed two ongoing administrative proceedings under Rule 102(e) against accountants for alleged failures to conduct audits in accordance with professional standards. Rule 102(e) is the SEC's primary mechanism for regulating professionals, and allows the agency to censure or bar professionals from practicing before it. The dismissals came in the wake of the Supreme Court's June 27, 2024 opinion in *SEC v. Jarkesy*, 603 U.S. __ (2024). The Supreme Court's opinion, which is discussed in more depth in Gibson Dunn's client alert, held that the Seventh Amendment requires the SEC to sue in federal court, not in the agency's in-house court, when the SEC seeks civil penalties for fraud. Although the *Jarkesy* opinion did not directly address proceedings under Rule 102(e), the SEC's dismissal of two proceedings under this Rule suggest the agency may believe litigating these proceedings administratively may be unconstitutional under *Jarkesy*. Notably, both proceedings had been challenged by the defendant accountants in federal court.

- On September 17, 2024, the SEC announced it had settled charges against Prager Metis CPAs, LLC related to two actions the SEC filed against the firm in federal court. The first action, filed in the U.S. District Court for the Southern District of New York on the same day, alleged that Prager Metis falsely misrepresented that two audit reports it issued of FTX in February 2021 and April 2022 complied with Generally Accepted Auditing Standards (GAAS). Prager Metis agreed to permanent injunctions, a $745,000 civil penalty, and remedial actions, including retaining an independent consultant. The second action, which also involved Prager Metis's California firm, Prager Metis CPAs LLP, was filed in U.S. District Court for the Southern District of Florida in September 2023 for alleged violations of auditor independence rules based on the inclusion of indemnification provisions in engagement letters for audits, reviews, and examinations. The settlements in this action provide for permanent injunctions, a combined $1 million penalty, and $205,000 of disgorgement, including pre-judgment interest.

- On September 24, 2024, the PCAOB announced settled orders with five separate firms. Four of these firms faced alleged violations involving communications with their clients' respective audit committees, including providing non-audit services without receiving prior approval from the issuers' audit committees. The fifth firm allegedly failed to make required disclosures on Form 3 related to a disciplinary proceeding brought by the SEC against the firm and its named partner.

Regulatory

- In July and September 2024, the PCAOB issued three Spotlight publications. The first shared observations from the PCAOB's recent outreach to audit firms and public companies to understand their integration of GenAI in audits and financial reporting. The second discussed purported deficiencies in baking sector audits in 2022 and 2023. The third shared observations on auditor independence to help audit firms comply with PCAOB and SEC independence standards and rules, including discussion of common deficiencies and good practices.

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For further information about any of the topics discussed herein, please contact one of the Accounting Firm Advisory and Defense Practice Group Chairs or the Gibson Dunn attorney with whom you regularly work.