

Key Takeaways from SEC Settlement with China-Based Cloopen Group Limited

News

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This week, the SEC filed settled fraud charges against Cloopen Group Limited, a China-based provider of cloud communications products and services, whose shares traded on the NYSE during the relevant period. According to the SEC's Order, two of Cloopen's senior managers engaged in a fraudulent scheme to recognize revenue prematurely on service contracts in order to meet quarterly sales targets. As a result, Cloopen's total revenues were overstated by 4% in Q2 2021 and by 6% Q3 2021.

As the SEC highlighted in the Order, the company self-reported the misconduct after the errors were identified by its external auditor.

Partners Jennifer Lee and Charles Riely share a few thoughts on this case:

- The settlement against Cloopen does not include a penalty against the company, and Enforcement Director Grewal's quote announcing the case emphasized that this decision was premised on Cloopen's cooperation and remediation. In this regard, the settlement is consistent with recent Enforcement cases in the past year. Collectively, these suggest that, even with extraordinary cooperation, the SEC is much more likely to not assess a civil penalty rather than decline to bring charges. In other words, if there is a violation, the absence of a civil penalty may be a ceiling for cooperation credit in SEC cases.
- A notable footnote here is that the company is based in a foreign jurisdiction. Accordingly, it is likely difficult, if not impractical, for the SEC to enforce penalties against an entity in China. Ultimately, it is hard to tell whether and how Enforcement weighed this reality when exercising their discretion not to obtain civil penalties.
- Along those lines, the settlement does not include charges against the senior managers implicated in the scheme. This may be because they are foreign actors beyond the jurisdictional reach of the SEC. Notably, the SEC cannot plead general corporate scienter and must premise fraud actions on individual misconduct.
- Finally, the settlement identified \$228,000 in SOX 304 remedies against the CEO and CFO of Cloopen, even though neither was named as a defendant. The order does not provide detail as to

how the SEC determined these amounts or parse out which executive paid what amounts in clawbacks. Ultimately, the settlement may be signaling more flexibility from Enforcement in how they are settling SOX 304 clawback issues.

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