Financial Regulatory Alert

Akin Gump
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SEC Brings First-Ever 'Alternative Data' Enforcement Action

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Key Points

- The SEC has charged App Annie, Inc. and its former CEO with violations of Section 10(b) of the Exchange Act and Rule 10b-5, which constitute the primary mechanism for enforcing insider trading violations.
- This action (which was settled for over $10 million) is the SEC's first enforcement action charging an alternative data provider with securities fraud.
- Alternative data is one of the SEC's examination priorities, and the contribution of the Division of Examination was expressly noted in the SEC's public statements. It is likely only the beginning of the trend towards greater regulatory oversight of the alternative data space.

The U.S. Securities and Exchange Commission announced Tuesday that it has reached a settlement in its first enforcement action charging an alternative data provider with securities fraud. App Annie, Inc., a leading alternative data provider for the mobile app industry, and its co-founder and former CEO, agreed to settle securities fraud charges for engaging in deceptive practices and making material misrepresentations about how App Annie's alternative data was derived. The SEC found that these material misrepresentations were made "in connection with" the purchase and sale of securities. App Annie and the former CEO have agreed to pay more than $10 million to settle the matter.

"Alternative data," i.e., information not contained within a public company's financial statements or other traditional data sources, has become a substantial input into the research processes of many investment management firms. For its part, App Annie is one of the largest sellers of market data derived from mobile apps.

Findings

App Annie offered a free product called "Connect" (formerly called "Analytics") that provided app sponsors the ability to analyze how their apps were performing. A sponsor would provide App Annie with its App Store credentials and App Annie would download the app-related performance data ("Connect Data") for analysis. App Annie then sold its estimates of app performance through a paid subscription product called

Contact Information

If you need assistance or have questions regarding this alert, please contact your Akin Gump relationship attorney or one of the authors.

Peter I. Altman
Partner
paltman@akingump.com
Los Angeles
+1 310.728.3085

Michael A. Asaro
Partner
masaro@akingump.com
New York
+1 212.872.8100

James Joseph Benjamin Jr.
Partner
jbenjamin@akingump.com
New York
+1 212.872.8091

Paul W. Butler
Partner
pbutler@akingump.com
Washington, D.C.
+1 202.887.4069

Charles F. Connolly
Partner
cconnolly@akingump.com
Washington, D.C.
+1 202.887.4070

Brian T. Daly
Partner
bdaly@akingump.com
New York
+1 212.872.8170

"Intelligence." More than 100 investment advisers and other firms paid for Intelligence subscriptions for use in their research process. In marketing its products, App Annie touted itself as providing "the most accurate app performance estimates in the industry" and actively encouraged its trading firm customers to use its estimates to trade securities ahead of upcoming earnings announcements.

The SEC found that App Annie made material misrepresentations regarding its business model to both the app sponsors and its trading firm customers. Specifically, the SEC found that App Annie and the former CEO: (1) falsely assured sponsors that their Connect Data would be aggregated and anonymized before being used by App Annie's statistical model to generate app performance analyses, and (2) misrepresented to their trading firm customers that App Annie generated its estimates in a way that was consistent with the consents it obtained from app sponsors, and that App Annie had effective internal controls to prevent the misuse of confidential data and to ensure that it was in compliance with the federal securities laws. The SEC order found that, contrary to its representations, App Annie used non-aggregated and non-anonymized data to alter its model-generated estimates to make them more accurate.

The SEC concluded that, by engaging in this conduct, App Annie and its former CEO violated the antifraud provisions of the federal securities laws, which prohibit fraudulent and deceptive conduct "in connection with the purchase or sale of securities." While the SEC's order does not cite any specific case law, this would not be the first time the agency has taken the position that the "in connection with" requirement can be satisfied when someone makes an affirmative misrepresentation in an effort to obtain non-public information that can be used to make profitable securities trades.[1] It is worth noting, however, that not all of the SEC's Commissioners appear to have concluded that the "in connection with" requirement was satisfied in the App Annie case.

After the settlement was announced, Commissioner Hester Peirce released the following statement on Twitter: "This settlement stretches the 'in connection with the purchase or sale of securities' requirement . . . beyond where I think it should go." However, the fact that the Commission ultimately approved the settlement demonstrates that the majority of the Commissioners disagreed with her minority view.

Implications

This action has clear implications for private fund managers and other traders of listed securities. Given the novelty and the velocity of this matter, and the number of questions it raises, we will be hosting a live webinar on this case and its implications. Invitations will follow this alert.

[1] The U.S. Court of Appeals for the Second Circuit endorsed the SEC's use of a similar theory in an insider trading action in *SEC v. Dorozhko*, 574 F.3d 42 (2d Cir. 2009), which involved a computer hacker who allegedly misrepresented their identity in order to get access to confidential earnings information.

akingump.com

Jason M. Daniel
Partner
jdaniel@akingump.com
Dallas
+1 214.969.4209

Estela Díaz
Partner
ediaz@akingump.com
New York
+1 212.872.8035

Katherine R. Goldstein
Partner
kgoldstein@akingump.com
New York
+1 212.872.8057

Claudius B. Modesti
Partner
cmodesti@akingump.com
Washington, D.C.
+1 202.887.4040

Parvin Daphne Moyne
Partner
pmoyne@akingump.com
New York
+1 212.872.1076

Barbara Niederkofler
Partner
bniederkofler@akingump.com
New York
+1 212.872.8149

Lauren E. Huennekens
Associate
lhuennekens@akingump.com
Los Angeles
+1 310.229.1019