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SEC fines Zenefits and former CEO Parker Conrad

By Rujie Zhou, LL.M. Candidate 2018 | November 3, 2017

On October 26, 2017, the Securities and Exchange Commission (the "SEC") fined a Silicon Valley unicorn startup, Zenefits, and its former CEO Parker Conrad for "materially false and misleading statements and omissions" to the company's investors regarding non-compliance with state insurance laws. This is a first for a Silicon Valley startup.

Zenefits and Conrad agreed to pay a combined nearly $1 million in fines to settle accusations. The company agreed to pay $450,000 and Conrad agreed to pay nearly $534,000, of which $350,000 represents disgorgement of ill-gotten gains and a penalty of $160,000. But Zenefits did not confirm or deny the SEC's findings that they violated federal securities laws.

San Francisco-based Zenefits makes software for business to automate their human resources activities, but also acts as a health insurance broker. 90 percent of the company's revenue comes from brokerage fees from their health insurance business.

The SEC claimed that Zenefits used inadequate compliance procedures under Conrad's control, allowing employees to sell health insurance without the necessary state licenses. Conrad created and shared a program allowing employees to complete California licensing education requirements in fewer hours than the law required. Separately, in 2016, in a concession to investors, Zenefits slashed its valuation by more than half to $2 billion from $4.5 billion and investors agreed not to sue Zenefits. The SEC asserted that when Zenefits and Conrad raised funds in 2014 and 2015, they failed to adequately disclose their knowledge of these compliance lapses.

In contrast to the SEC's broad authority to police behavior in public traded companies, it has relatively limited authority in the world of private companies; by law, it can only police misrepresentations and fraud in the sale of private company stock. Zenefits is the first case in which the SEC took action against a privately held Silicon Valley startup for misleading its investors. In the future, the SEC will keep a watchful eye on Zenefits.