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SEC Enforcement Actions over Stock Transaction Reporting Obligations Offer Reminders for Public Companies and Their Insiders

The SEC recently announced enforcement actions against 34 companies and individuals for alleged failure to timely file with the SEC stock transaction reports provide important lessons to companies and their insiders. They also provide valuable insight into the current SEC enforcement environment.

By Marc J. Fagel, Elizabeth A. Ising, James Moloney, and Ronald O. Mueller

On September 10, 2014, the Securities and Exchange Commission (SEC) announced an unprecedented enforcement sweep against 34 companies and individuals for alleged failures to timely file with the SEC various Section 16(a)

filings (Forms 3, 4, and 5) and Schedules 13D and 13G (September 10 actions).¹ The September 10 actions named 13 corporate officers or directors, five individuals and 10 investment firms with beneficial ownership of publicly traded companies, and six public companies; all but one settled the claims without admitting or denying the allegations. The SEC emphasized that the filing requirements may be violated even inadvertently, without any showing of scienter. Notably, among the executives targeted by the SEC were some who had provided their employers with trading information and relied on the company to make the requisite SEC filings on their behalf.

In a much-discussed speech last year, SEC Chair Mary Jo White explained that she would be implementing a “broken windows” strategy of pursuing frequently overlooked minor violations, highlighting that it was “important to pursue even the smallest infractions.”² This latest SEC sweep clearly is intended as a warning for public companies and their officers, directors, and significant beneficial owners that the SEC is vigorously investigating and enforcing even the more technical, non-fraud provisions of the federal securities laws.

The Enforcement Sweep

In the September 10 actions, the SEC charged 34 companies and individuals with violations of

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Sections 16(a), 13(a), 13(d), and/or 13(g) of the Securities Exchange Act of 1934 (Exchange Act) and the applicable rules thereunder for failing to timely file various forms required to be filed with the SEC. Of the 34 respondents named in the orders, 33 settled the claims and agreed to pay financial penalties in the aggregate amount of \$2.6 million.

Section 16(a) of the Exchange Act and Rule 16a-3 thereunder require executives, directors and greater than 10 percent shareholders of U.S. public companies to file an initial statement of equity security holdings on a Form 3 within 10 days of becoming an insider, and to publicly report transactions in the company's securities on Form 4 within two business days following the execution date of the transaction. Insiders also are required to file an annual statement on Form 5 to report, among other things, gifts and any transactions that should have been, but were not, disclosed on Form 3 or 4 during the most recent fiscal year.

Alleged violations of the Section 16(a) reporting requirements are enforced only by the SEC, and there is no intent or other state of mind requirement for a violation; inadvertent failures to timely file may constitute violations of the federal reporting requirements.

In several of the September 10 actions, the officer or director informed the SEC that they had provided timely transaction information to their employer, but the issuer had failed to timely file reports on the individual's behalf. The SEC nonetheless found in these circumstances that the issuer's failure "does not excuse [the officer or director's] violations because an insider retains legal responsibility for compliance with the filing requirements, including the obligation to assure that the filing is timely and accurately made."

The SEC also charged several public companies for causing violations of Section 16(a).

The SEC states in several of these orders that "[a]lthough [it] encourages the practice of many issuers to assist insiders in complying with Section 16(a) filing requirements, issuers who voluntarily accept certain responsibilities and then act negligently in the performance of those tasks may be liable" in causing Section 16(a) violations.

In addition, the issuers were charged under Section 13(a) of the Exchange Act and Rule 13a-1 thereunder. These provisions require public companies to file annual reports or proxy statements containing specific information and, as part of that obligation, to comply with Item 405 of Regulation S-K. Item 405 in turn requires the public company to review Forms 3, 4, and 5 and disclose in its annual report or proxy statement any known instances in which a corporate insider failed to make a Section 16(a) filing or was late in doing so. As with Section 16(a), there is no intent requirement under Section 13(a).

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reporting requirements.***

Finally, though not the primary focus of the sweep, the SEC also charged noncompliance by certain individuals and issuers with Sections 13(d) and 13(g) of the Exchange Act, which impose filing requirements on beneficial owners of greater than five percent of the equity securities of a public company.

Key Considerations

In light of the September 10 actions, which make clear that the SEC is focused keenly on compliance with these rules, public companies, along with their officers and directors and significant shareholders, should take immediate steps to minimize their exposure to potential SEC enforcement interest.

First, legal and compliance personnel should review and, if necessary, strengthen their internal processes regarding the collection of trading information and timely reporting of all covered securities transactions. Steps to consider include identifying the insiders subject to the reporting requirements, providing training or materials highlighting the nature and scope their reporting responsibilities, and having the board of directors approve the list of Section 16(a) officers at least annually.

Second, officers, directors and others who rely on the company for compliance with Sections 13(d) and 16(a) filing requirements should take adequate and effective steps to ensure that timely and accurate filings are made on their behalf, such as making sure that the company is aware of all of their (and their family members') stock holdings, making sure that the company is promptly informed of any transactions or other changes in holdings (including by their brokers), and reviewing SEC reports that are prepared and filed on their behalf.

The SEC is investing in more sophisticated surveillance mechanisms that allow the staff to detect even minor violations.

Broader Lessons

More broadly, the SEC's latest initiative provides valuable insight into the current SEC enforcement environment that should be considered by all public companies and their insiders. First, the SEC is investing in more sophisticated surveillance mechanisms that allow the staff to detect even minor violations that might otherwise have escaped notice. Enforcement Division Director Andrew Ceresney explained in the SEC's press release that the staff used "quantitative

analytics" to identify instances of late filings. This approach is consistent with ongoing Enforcement efforts to proactively identify potential accounting irregularities through qualitative and quantitative analysis of financial statements. To mitigate such risks, companies need to carefully conduct their own periodic review of various metrics to identify potential problems before the SEC does it for them.

Second, this matter is just the latest example of the SEC using quick investigations and broad, multi-party sweeps to attack seemingly lesser, non-fraud violations. Last year, a similar approach was used to file suit against nearly two dozen investment firms for alleged short selling violations under Rule 105 of Regulation M.

(Editor's note: On September 16, 2014, the SEC announced enforcement action against 19 firms and one individual for short selling violations under Rule 105.)

As Ceresney emphasized in the SEC's press release, "[I]nadvertence is no defense to filing violations, and we will vigorously police these sorts of violations through streamlined actions." The SEC appears to be increasingly seeking to send a stern message to corporate America that not just major frauds, but violations of non-scienter regulations may result in enforcement actions. In this environment, public companies need to be particularly attuned to the effectiveness of their compliance procedures and promptly remediate even minor issues before a technical violation can occur.

Finally, the September 10 actions demonstrate a stark departure from past Enforcement actions and represent a surprisingly aggressive stance by the SEC. The SEC has filed virtually no stand-alone late filing cases (absent additional, more serious violations) in well over a decade. And when it did pursue such claims in past years, it almost invariably resolved them with a cease-and-desist order, not monetary penalties. Not only

did these cases appear to come with no warning, but the SEC's orders explicitly recognized the settling parties' remedial acts and cooperation with the SEC staff, yet the agency nonetheless pursued enforcement actions coupled with penalties. Companies and their insiders must now be concerned about facing significant sanctions, without warning, for infractions that previously had not been on the SEC's radar screen.

Notes

1. SEC Press Release, SEC Announces Charges Against Corporate Insiders for Violating Laws Requiring Prompt Reporting of Transactions and Holdings (Sept. 10, 2014), available at: www.sec.gov/News/PressRelease/Detail/PressRelease/1370542904678.
2. Chair Mary Jo White, Remarks at the Securities Enforcement Forum (Oct. 9, 2013), available at: www.sec.gov/News/Speech/Detail/Speech/1370539872100.

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