Simpson Thacher

Memorandum

SEC Charges Eight Insiders For Failing to Update Stock Ownership Disclosures

April 3, 2015

On March 13, 2015, the Securities and Exchange Commission ("SEC") announced that it had filed administrative cease-and-desist proceedings against eight officers, directors, or major shareholders in connection with three going-private transactions due to their alleged failure "to update their stock ownership disclosures to reflect material changes, including steps to take the companies private."[1] Each of the respondents agreed to pay fines ranging from $15,000 to $75,000 to settle the charges, without admitting or denying the SEC's allegations.

Schedule 13D Filing Requirements

Section 13(d)(1) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), and Rule 13d-1(a) thereunder generally provide that any person who directly or indirectly acquires the beneficial ownership of more than 5% of any voting class of a company's equity security registered under Section 12 of the Exchange Act must file a Schedule 13D with the SEC within ten days after such acquisition, disclosing certain information pertaining to the beneficial ownership (unless such person otherwise qualifies to file on a Schedule 13G). The information required to be disclosed on Schedule 13D includes:

- the identity and background of the acquirer;
- a description of the purposes of the acquisition, including any plans or proposals that the reporting person may have that relate to or would result in certain events, including (i) a change in the present board of directors or management and (ii) an extraordinary corporate transaction, such as a merger, reorganization, or liquidation; and

[1] U.S. Securities and Exchange Commission, "Corporate Insiders Charged for Failing to Update Disclosures Involving 'Going Private' Transactions" (Mar. 13, 2015).

- "the interest in securities of the issuer of all persons making the filing, including those acting together as a group."[2]

Section 13(d)(2) and corresponding Rule 13d-2(a) require the prompt filing of an amendment in the event that "any material change occurs in the facts set forth in the Schedule 13D."[3]

The SEC's Findings

The SEC found that each of the eight respondents took "a series of significant steps that, when viewed together, resulted in a material change from the disclosures that each had previously made in their Schedule 13D filings."[4] Specifically, according to the SEC, each of the respondents initiated significant steps to further a going-private transaction, which the SEC explained is "an extraordinary corporate transaction that triggers a reporting obligation."[5] Examples of actions the SEC viewed, in light of the particular facts and circumstances of each case, as indications that the respondent planned to effect going-private transactions include:

- informing management of an intention to privatize the company;
- discussing strategies with management for going private;
- deciding on the form of the transaction that would be used to take the company private;
- informing management that they supported the going-private transaction and assisting management in that effort, including by securing waivers from certain shareholders to remove a registration requirement on certain preferred stock;
- working with the company to obtain a valuation and fairness opinion in connection with a reverse stock split transaction and discussing a valuation proposal with certain officers and directors;
- assisting the company with shareholder vote projections on a reverse stock split and going-private transaction;
- studying the feasibility of a going-private transaction and reviewing other going-private transactions involving certain types of issuers; and
- engaging in discussions with attorneys and consortium members about working together to submit a going-private proposal to the company.

Importantly, the SEC noted in the announcement that the relevant actions needed to be viewed together in order to determine whether or not there had been a material change from the disclosures previously made in

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[2] Exchange Act Rule 13d-101 (Schedule 13D).

[3] Exchange Act Rule 13d-2(a). Among the SEC's "Compliance and Disclosure Interpretations" ("C&DIs") regarding Schedule 13D is C&DI 110.06, which clarifies that "[g]eneric disclosure reserving the right to engage in any of the kinds of transactions enumerated in Item 4(a)-(j) [of Schedule 13D] must be amended when the security holder has formulated a specific intention with respect to a disclosable matter."

[4] "Corporate Insiders Charged for Failing to Update Disclosures Involving 'Going Private' Transactions," *supra* note 1.

[5] *In the Matter of William A. Houlihan*, Release No. 34-74504, File No. 3-16442 (Mar. 13, 2015).

a Schedule 13D. As a result, we believe that certain of the foregoing actions when viewed in isolation, as opposed to in combination with other actions, often would not be viewed as a dispositive indication that the respondent planned to effect a going-private transaction.

According to the SEC, none of the respondents amended their Schedule 13D filings promptly, as required.[6] Instead, the respondents waited between three and nine months before updating their Schedule 13D disclosures. In all but one of the cases, the respondents also failed to amend their Schedule 13D disclosures to report the subsequent acquisition of additional shares – or only amended their Schedule 13Ds months or years later.[7] Accordingly, the SEC charged each of the respondents with violations of Section 13(d)(2) and Rule 13d-2(a).

In one or more of the cases, the SEC also charged the respondent with violations of:

- Exchange Act Section 13(d)(1) and Rule 13d-1, for failure to file an initial Schedule 13D until nineteen months after incurring a reporting obligation;[8]
- Exchange Act Section 16(a) and Rule 16a-3, which require each "beneficial owner of more than 10 percent of any class of any equity security (other than an exempted security) which is registered pursuant to Section 12" of the Exchange Act and each director or officer of the issuer of such a security to file Form 4 reports disclosing a change in beneficial ownership. Such a form must be filed before the end of the second business day following the day on which the applicable transaction has been executed, subject to certain exemptive rules established by the SEC. In each case implicating Section 16(a) and Rule 16a-3, the respondent failed to disclose material transactions until months or years later.[9]

Implications of the SEC's Charges

This group of enforcement actions is the most recent example of the SEC's "broken windows" enforcement philosophy in action, underscoring the importance of full compliance with Sections 13(d) and 16(a) and the rules thereunder. The SEC's charges are a reminder that there is no state of mind requirement for violations of Sections 13(d) or 16(a); "[t]he failure to timely file a required report, even if inadvertent, constitutes a

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[6] "Corporate Insiders Charged for Failing to Update Disclosures Involving 'Going Private' Transactions," *supra* note 1.

[7] *See In the Matter of Shuipan Lin*, Release No. 34-74497, File No. 3-16435 (Mar. 13, 2015); *In the Matter of William A. Houlihan*, *supra* note 5; *In the Matter of SMP Investments I, LLC*, Release No. 34-74502, File No. 3-16440 (Mar. 13, 2015); *In the Matter of Brian Potiker*, Release No. 34-74503, File No. 3-16441 (Mar. 13, 2015); *In the Matter of The Ciabattoni Living Trust Dated August 17, 2000*, Release No. 34-74499, File No. 3-16437 (Mar. 13, 2015); *In the Matter of Jane G. Ciabattoni*, Release No. 34-74501, File No. 3-16439 (Mar. 13, 2015); *In the Matter of Anthony J. Ciabattoni*, Release No. 34-74500, File No. 3-16438 (Mar. 13, 2015).

[8] *See In the Matter of Shuipan Lin*, *supra* note 7.

[9] Section 16(a) of the Exchange Act, 15 U.S.C. § 78p(a). *See In the Matter of William A. Houlihan*, *supra* note 5; *In the Matter of SMP Investments I, LLC*, *supra* note 7, *In the Matter of Brian Potiker*, *supra* note 7; *In the Matter of The Ciabattoni Living Trust Dated August 17, 2000*, *supra* note 7; *In the Matter of Jane G. Ciabattoni*, *supra* note 7, *In the Matter of Anthony J. Ciabattoni*, *supra* note 7.

violation."[10] Moreover, the charges exemplify the SEC's view that – in the words of Enforcement Division Director Andrew J. Ceresney – "[i]nvestors are entitled to current and accurate information about the plans of large shareholders and company insiders. Stale, generic disclosures that simply reserve the right to engage in certain corporate transactions do not suffice when there are material changes to those plans, including actions to take a company private."[11]

The requirement to amend Schedule 13D with respect to plans or proposals related to the issuer and its securities is often highly dependent on the particular facts and circumstances, including the existing disclosures with respect to plans or proposals in the filing party's Schedule 13D. The recent SEC enforcement actions highlight both the importance of careful drafting of the purposes, plans and proposals disclosures in any initial Schedule 13D filing and subsequently conferring with counsel at an early stage (and on an ongoing basis thereafter, as facts and circumstances change) regarding the timing and content of any disclosure obligation that potentially could be triggered when contemplating actions with respect to an issuer, particularly going-private and other extraordinary corporate transactions. It is also important to note that such disclosure obligations include those of other significant shareholders who are, or may become, involved in such a proposed transaction.

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[10] *In the Matter of William A. Houlihan, supra* note 5.

[11] "Corporate Insiders Charged for Failing to Update Disclosures Involving 'Going Private' Transactions," *supra* note 1.

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