Simpson Thacher

Memorandum

SEC Charges Ten Companies With Failure to File Forms 8-K

November 7, 2014

Introduction

On November 5, 2014, the Securities and Exchange Commission ("SEC") instituted settled cease-and-desist proceedings against ten companies for their failure to file Forms 8-K to disclose (1) the unregistered sales of equity securities and (2) financing agreements.[1]

Under Item 1.01 of Form 8-K, a registrant must disclose any "material definitive agreement not made in the ordinary course of business of the registrant."[2] A "material definitive agreement" is "an agreement that provides for obligations that are material to and enforceable against the registrant, or rights that are material to the registrant and enforceable by the registrant against one or more other parties to the agreement, in each case whether or not subject to conditions." Item 3.02 of Form 8-K requires a registrant to disclose the sale of equity securities "in a transaction that is not registered under the Securities Act" of 1933. Disclosure is not required "if the equity securities sold, in the aggregate since its last report filed under . . . Item 3.02 or its last periodic report, whichever is more recent, constitute less than 1%" – or, for a smaller reporting company, 5% – "of the number of shares outstanding of the class of equity securities sold." Under each of these items, the registrant is required to make the requisite disclosure within four business days of the date of the occurrence or the date the agreement becomes enforceable against the registrant.

Each of the companies charged by the SEC entered into an agreement with a financing company pursuant to which the company "issued shares of common stock to the financing company purportedly in reliance on a

[1] *See* U.S. Securities and Exchange Commission, "SEC Sanctions 10 Companies for Disclosure Failures Surrounding Financing Deals and Stock Dilution" (Nov. 5, 2014). One of the ten companies was charged only with failing to disclose unregistered sales of equity securities.

[2] Form 8-K, Current Report Pursuant to Section 13 OR 15(d) of the Securities Exchange Act of 1934.

registration exemption found in Section 3(a)(10) of the Securities Act of 1933."[3] However, none of the companies filed Forms 8-K to disclose these agreements as required under Item 1.01. In addition, each of the companies sold unregistered shares of common stock in excess of the 5% threshold for smaller reporting companies, yet failed to disclose the sales. In each case, the company charged by the SEC missed two or more Form 8-K filings.

Three of the ten companies were also charged with filing a Form 10-K or 10-Q that incorrectly reported the number of shares of common stock outstanding (by more than 20%, 24%, and 45%, respectively). In one other case, the company was also charged with failing to make any of its required annual and quarterly filings with the SEC.

The SEC charged each of the ten companies with violations of Section 13(a) of the Exchange Act and Rule 13a-11 thereunder, "which require every issuer of a security registered pursuant to Section 12 of the Exchange Act to file with the Commission information as the Commission may require, including current reports on Form 8-K to disclose the occurrence of certain events."[4] The companies that also failed to file or filed inaccurate Forms 10-K and/or 10-Q were also charged with violations of Rules 13a-1, 13a-13, and/or 12b-20, which generally require registrants to file annual and quarterly reports that are not materially misleading.

Implications of the SEC's Charges

As observed by Andrew J. Ceresney, the director of the SEC's Division of Enforcement, the recent enforcement actions "reinforce the ongoing need for full disclosure to shareholders concerning an issuer's entry into highly dilutive financing agreements."[5] More broadly, these enforcement actions highlight the importance of maintaining robust disclosure controls and procedures to reasonably ensure that Forms 8-K are filed promptly.

Like the charges the SEC brought recently against individuals and public companies for the delinquent filing of reports required by Sections 16(a), 13(d) and/or 13(g) of the Securities Exchange Act of 1934, the current enforcement initiative is emblematic of the SEC's "broken windows" enforcement policy.[6] The policy, explained by SEC Chair Mary Jo White last year, is predicated on the notion that "when a window is broken and someone fixes it – it is a sign that disorder will not be tolerated. But, when a broken window is not fixed,

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[3] *See, e.g., In the Monster Arts, Inc.*, Release No. 73519, File No. 3-16250 (Nov. 5, 2014).

[4] *Id.*

[5] Securities and Exchange Commission, *supra* note 1.

[6] *See* Memorandum of Simpson Thacher & Bartlett LLP, "SEC Charges 34 Insiders, Shareholders and Public Companies with Delinquencies in Reporting Stock Holdings and Trades" (Sept. 22, 2014).

it is a signal that no one cares, and so breaking more windows costs nothing."[7] Chair White explained that this theory "can be applied to our securities markets – minor violations that are overlooked or ignored can feed bigger ones, and, perhaps more importantly, can foster a culture where laws are increasingly treated as toothless guidelines." Accordingly, Chair White voiced a commitment "to pursue even the smallest infractions" of the federal securities laws. Given the SEC's stated philosophy, the trend of enforcing less serious (and, in some cases, previously unenforced) infractions is expected to continue.

If you have any questions or would like additional information, please do not hesitate to contact **Yafit Cohn** at (212) 455-3815 or yafit.cohn@stblaw.com, or any other member of the Firm's Public Company Advisory Practice.

[7] Mary Jo White, "Remarks at the Securities Enforcement Forum" (Oct. 9, 2013) (internal quotations and citation omitted).

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