

Memorandum

SEC Charges MusclePharm Corporation With Failure to Properly Report Executives' Perks and Other Violations

September 24, 2015

On September 8, 2015, the Securities and Exchange Commission (“SEC”) instituted settled administrative cease-and-desist proceedings against MusclePharm Corporation (“MusclePharm”) as a result of its alleged disclosure and accounting violations, including inaccurate reporting of perquisite compensation paid to its executives.¹ The SEC also entered into settled administrative cease-and-desist proceedings against three current and former MusclePharm executives, as well as its former audit committee chairman, due to their alleged involvement in the company’s misconduct.²

Factual Background and SEC Findings

According to the SEC, MusclePharm, a sports supplements and nutrition company, experienced rapid growth following its initial public offering in 2010, but lacked the proper internal controls and bookkeeping procedures to support such growth and comply with the SEC’s reporting requirements. The SEC found that the company consequently experienced numerous disclosure and accounting issues between 2010 and 2013, which ultimately resulted in MusclePharm “filing materially false and misleading filings” with the SEC between 2010 and July 2014.³ In its order, the SEC specifically alleged that the company failed to accurately report perquisites provided to its executives, among other reporting and accounting violations, and engaged

¹ See [In the Matter of MusclePharm Corporation](#), Release No. 34-75851 (Sept. 8, 2015); see also U.S. Securities and Exchange Commission, “[SEC Charges Sports Nutrition Company With Failing to Properly Disclose Perks for Executives](#)” (Sept. 8, 2015).

² See *In the Matter of L. Gary Davis, CPA*, Release No. 34-75854 (Sept. 8, 2015); *In the Matter of Lawrence S. Meer, CPA*, Release No. 34-75853 (Sept. 8, 2015); *In the Matter of Donald W. Prosser, CPA*, Release No. 34-75855 (Sept. 8, 2015); *In the Matter of Brad J. Pyatt*, Release No. 34-75852 (Sept. 8, 2015); see also “SEC Charges Sports Nutrition Company With Failing to Properly Disclose Perks for Executives,” *supra* note 1.

³ *In the Matter of MusclePharm Corporation*, *supra* note 1, at 2.

in the unregistered offering and sale of securities.

With regard to the inaccurate perquisite disclosure, the SEC concluded that from 2010 to July 2014, MusclePharm understated its reported perquisite compensation by approximately 76%, or \$482,000, in its proxy statements, Forms S-1 and Forms 10-K. The undisclosed perquisites included two golf club memberships, personal professional legal and tax services, automobiles, meals and clothing for its chief executive officer (“CEO”), as well as golf club memberships and medical costs of an eye surgery and a child’s birth for other executives. From the SEC’s perspective, the executives knew or should have known since 2010 that such perquisites were required to be reported, but continuously failed to completely and accurately identify all perquisites in the company’s filings. Furthermore, the company commenced an internal investigation of its perquisite compensation during the summer of 2013, in which it identified over \$100,000 of undisclosed perquisites, yet MusclePharm continued to file disclosures that significantly understated such compensation.

The SEC alleged MusclePharm committed other disclosure and accounting violations, as well. For example, the company allegedly failed to implement related party transaction policies and properly disclose significant related party transactions in its SEC filings from May 2011 to May 2013. These transactions occurred with a major customer whose CEO and owner of more than 10% of this customer was the brother of MusclePharm’s chief marketing officer (“CMO”). Moreover, MusclePharm’s chief financial officer (“CFO”) had previously served as CFO of this major customer and held a 1.75% indirect interest in it. MusclePharm’s auditor twice informed the company of the required related party transaction disclosure after both the CMO and CFO were hired. Each response from MusclePharm contained inaccurate information regarding these relationships and concluded that the transactions did not prompt disclosure under generally accepted accounting principles (“GAAP”). The SEC further alleged that MusclePharm violated federal securities laws by:

- failing to disclose its CEO’s personal bankruptcy, the bankruptcies of two companies owned by its former CFO, the amount of its international sales, \$100,000 of rent under an aircraft lease agreement, a sponsor commitment totaling \$6.9 million and a supplier accounting for almost 100% of the company’s product purchases;
- inaccurately accounting for advertising and promotional related costs, which resulted in overstatements of revenue by 26%, or \$845,000, in 2010 and 21%, or \$3.6 million, in 2011;
- recording approximately \$1.5 million of loss on settlement of accounts payable in the wrong quarter, leading to additional disclosure errors;
- offering and issuing stock without a registration statement when entering into agreements with third parties who paid MusclePharm’s vendors in exchange for company stock;
- failing to receive and maintain manually signed signature pages for a majority of its SEC filings; and

- failing to implement effective internal accounting controls and bookkeeping procedures.

With respect to the individuals involved in MusclePharm's alleged wrongdoing, the SEC found that its CEO, Brad J. Pyatt, and former CFOs, L. Gary Davis and Lawrence S. Meer, "failed to ensure sufficient internal controls were enacted and proper books and records were kept."⁴ The SEC also concluded that Donald W. Prosser, the company's former audit committee chairman, became directly involved in the company's misconduct by initiating an internal review of the undisclosed perquisites and continuing to allow the inaccurate reporting of such compensation.⁵ Additionally, these individuals allegedly signed filings containing misstatements and omissions.

The Settlements

MusclePharm, its CEO, its two former CFOs and its former audit committee chairman entered into settlement agreements with the SEC without admitting or denying the SEC's findings. Under MusclePharm's settlement agreement, the company agreed to hire an independent monitor for one year to comprehensively review its internal controls, policies and training pertaining to perquisite compensation, related party transactions and financial statement disclosures in accordance with GAAP and to recommend any improvements to such internal controls, policies and training. The agreement also required the company, Pyatt, Davis and Prosser to pay civil penalties of \$700,000, \$150,000, \$30,000 and \$30,000, respectively. Furthermore, former CFOs Davis and Meer were suspended from serving as accountants to SEC-regulated entities, with the ability to reapply after two and three years, respectively.

Significance of the Action

This enforcement action emphasizes the importance of implementing and maintaining robust internal controls, policies and training to prevent accounting fraud and ensure accurate disclosure, especially with regard to perquisite compensation and related party transactions. The MusclePharm action is the second enforcement action in recent months relating to failure to disclose perquisites, highlighting the SEC's increased focus on perquisites.⁶ As articulated by Andrew Ceresney, Director of the SEC's Division of Enforcement, "Executive compensation is material information for investors, and companies must ensure that perks [they pay] for executives are properly recorded and disclosed in public filings."⁷

⁴ See *In the Matter of L. Gary Davis, CPA*, *supra* note 2, at 2; *In the Matter of Lawrence S. Meer, CPA*, *supra* note 2, at 2; *In the Matter of Brad J. Pyatt*, *supra* note 2, at 2.

⁵ See *In the Matter of Donald W. Prosser, CPA*, *supra* note 2, at 2.

⁶ For a discussion of the administrative cease-and-desist order against Polycom, Inc. and the complaint filed in federal court against Polycom's CEO, Andrew Miller, see Simpson Thacher & Bartlett LLP, "[SEC Charges Former CEO With Using Corporate Funds for Personal Perks Without Disclosure to Investors](#)" (Apr. 9, 2015).

⁷ "SEC Charges Sports Nutrition Company With Failing to Properly Disclose Perks for Executives," *supra* note 1.

The action also illustrates the SEC's recent attention to Rule 302 of Regulation S-T.⁸ To be in compliance, companies should ensure that they retain manually signed signature pages for SEC filings for at least five years and organize such signature pages in a manner that allows them to be easily located.

If you have any questions or would like additional information, please do not hesitate to contact **Yafit Cohn** at +1-(212)-455-3815 or yafit.cohn@stblaw.com, any other member of the Firm's Public Company Advisory Practice, or any of the following members of the Firm's Government and Internal Investigations Practice:

NEW YORK CITY

Nicholas S. Goldin

+1-212-455-3685
ngoldin@stblaw.com

Joshua A. Levine

+1-212-455-7694
jlevine@stblaw.com

Mark J. Stein

+1-212-455-2310
mstein@stblaw.com

WASHINGTON, D.C.

Peter H. Bresnan

+1-202-636-5569
pbresnan@stblaw.com

Jeffrey H. Knox

+1-202-636-5532
jeffrey.knox@stblaw.com

Cheryl J. Scarboro

+1-202-636-5529
cscarboro@stblaw.com

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⁸ See 17 C.F.R. § 232.302 (2002).



UNITED STATES

New York
425 Lexington Avenue
New York, NY 10017
+1-212-455-2000

Houston
600 Travis Street, Suite 5400
Houston, TX 77002
+1-713-821-5650

Los Angeles
1999 Avenue of the Stars
Los Angeles, CA 90067
+1-310-407-7500

Palo Alto
2475 Hanover Street
Palo Alto, CA 94304
+1-650-251-5000

Washington, D.C.
900 G Street, NW
Washington, D.C. 20001
+1-202-636-5500

EUROPE

London
CityPoint
One Ropemaker Street
London EC2Y 9HU
England
+44-(0)20-7275-6500

ASIA

Beijing
3901 China World Tower
1 Jian Guo Men Wai Avenue
Beijing 100004
China
+86-10-5965-2999

Hong Kong
ICBC Tower
3 Garden Road, Central
Hong Kong
+852-2514-7600

Seoul
25th Floor, West Tower
Mirae Asset Center 1
26 Eulji-ro 5-Gil, Jung-Gu
Seoul 100-210
Korea
+82-2-6030-3800

Tokyo
Ark Hills Sengokuyama Mori Tower
9-10, Roppongi 1-Chome
Minato-Ku, Tokyo 106-0032
Japan
+81-3-5562-6200

SOUTH AMERICA

São Paulo
Av. Presidente Juscelino
Kubitschek, 1455
São Paulo, SP 04543-011
Brazil
+55-11-3546-1000