Securities Lawyer Nightmares:

13 Mistakes that Keep Securities Lawyers Up at Night

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Today's Speakers

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Securities Lawyer Nightmares: 13 Mistakes that Keep Securities Lawyers Up at Night

Forgetting to Wear Clothes to School: Causes of Generalized Anxiety, Public Shame and Reputational Harm

Regulation FD Violations – Overview

- Regulation FD requires that whenever:
  - A company or a person acting on its behalf (covered person)
  - Discloses **material, nonpublic information**
  - To certain **market professionals or stockholders**
- A company must make public disclosure of that information:
  - Simultaneously (prior to or contemporaneously) for **intentional disclosures** or
  - Promptly (no later than 24 hours or before the next trading day) for **non-intentional disclosures**
- **High-risk events**
  - One-on-one investor calls
  - Q&A in “closed” analyst conferences
  - Social media
- **Safe spaces**
  - Confidential and business communications (particularly under NDA)
  - Properly announced earnings calls

Regulation FD Violations – CEO Social Media Posts

- In July 2012, the CEO of Netflix, Reed Hastings, revealed for the first time via a post on his personally, publicly available Facebook account that Netflix customers had streamed more than 1 billion hours of video in a month, marking a new record for the company
- In response, Netflix's stock jumped sharply, and the SEC sent a Wells Notice to Netflix and Hastings indicating its intent to bring charges for Reg. FD violations
- In April 2013, the SEC reversed course, determining not to pursue an enforcement action in this matter and instead releasing new guidance on how companies can use social media in compliance with Reg. FD
- Despite Netflix being let off the hook, it should be noted that Netflix had specific facts in its favor and Reg. FD still prohibits disclosure of material, non-public information through social media unless the company has taken steps to make the account a recognized channel of distribution

Reed Hastings · 204,990 subscribers
3 hours ago near Los Gatos ·

Subscribe

Congrats to Ted Sarandos, and his amazing content licensing team. Netflix monthly viewing exceeded 1 billion hours for the first time ever in June. When House of Cards and Arrested Development debut, we'll blow these records away. Keep going, Ted, we need even more!

Like · Share 16

136 people like this.

SECURITIES AND EXCHANGE ACT OF 1934
Release No. 69279 / April 2, 2013

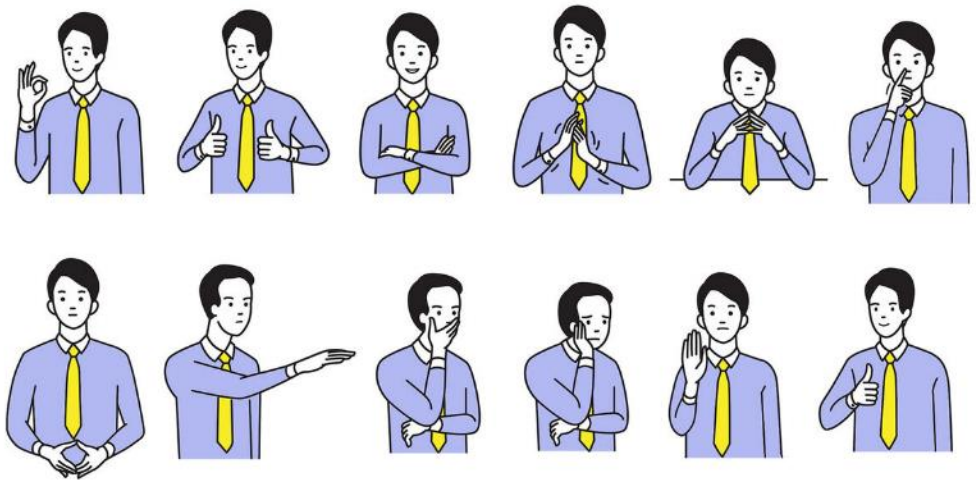
Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934: Netflix, Inc., and Reed Hastings

I. Introduction

The Division of Enforcement has investigated whether Netflix, Inc. ("Netflix") and its Chief Executive Officer, Reed Hastings ("Hastings") violated Regulation FD (17 C.F.R. §243.100 *et seq.*) and Section 13(a) of the Securities Exchange Act of 1934 ("Exchange Act"). The Commission has determined not to pursue an enforcement action in this matter. The investigation concerned Hastings's use of his personal Facebook page, on July 3, 2012, to announce that Netflix had streamed 1 billion hours of content in the month of June. Neither Hastings nor Netflix had previously used Hastings's personal Facebook page to announce company metrics, and Netflix had not previously informed shareholders that Hastings's Facebook page would be used to disclose information about Netflix. The post was not accompanied by a press release, a post on Netflix's own web site or Facebook page, or a Form 8-K.

Regulation FD Violations – Implied/Indirect Guidance

- Regulation FD can be violated by communicating material nonpublic information through indirect guidance, meaning where such guidance is apparent though implied
  - This may be through speaking in code or using body language (including tone, emphasis, and demeanor) to communicate
- In 2003, the SEC charged Schering-Plough and its former board chair and CEO, Richard Kogan, with violating Reg FD.
  - Schering agreed to pay a $1 million civil penalty and Kogan agreed to a $50,000 civil penalty and to cease and desist from committing such violations in the future
- The SEC found that Kogan and Schering's senior VP of IR met privately with analysts and portfolio managers for some of the company's biggest investors and through a combination of "spoken language, tone, emphasis, and demeanor," Kogan disclosed negative and material nonpublic information regarding the company's earning prospects



Trick and Treat

- **TRICK**: 
  - Company may make the determination that it has to publicize information prematurely, or publicize information it might prefer to otherwise keep quiet
  - This could also lead to enforcement actions against both the company and the responsible executives (*i.e.*, fines, cease and desist orders)
- **TREAT**: 
  - Implement a Regulation FD Policy and a Social Media Policy, and take steps to educate executives and IR team
  - Set procedures for analyst communications, and follow them
  - “Cultivate an environment of compliance”

Over-Issuances

- Form S-3
  - Form S-3s filed by non-WKSI companies must specify the maximum aggregate dollar amount of securities offered or a specific number of shares
    - This limits the number of securities that can be offered during the three-year life span of the shelf
  - In September 2022, Barclays agreed to a **$361 million settlement** to resolve SEC relating to its internal controls
- Form S-8
  - Form S-8 registers a finite number of shares that companies may not exceed without approval by their shareholders
  - Exceptions under federal or state law could apply, but if not, the company may need to take corrective measures such as:
    - Imposing transfer restrictions on grants already made to employees
    - Filing resale registration statements
    - Having the board conduct a rescission offer and "bust" resale trades

Barclays Agrees to a $361 Million Settlement to Resolve SEC Charges Relating to Over-Issuances of Securities

FOR IMMEDIATE RELEASE
2022-179

Washington D.C., Sept. 29, 2022 — The Securities and Exchange Commission today charged

Barclays to Pay $200 Million SEC Fine Over Debt-Sale Snafu
The British bank accidentally sold $17.7 billion worth of unregistered securities

The British bank had registered with the SEC to sell up to $20.8 billion in securities but sold some $38.5 billion worth instead.

WSJ

Barclays shares plunge 10% as profit falls

London CNN — Shares of Barclays tumbled nearly 10% Wednesday after the British bank reported a sharp drop in profit, driven by increased provisions for bad debts and huge fines for wrongly sold securities in the United States.

CNN BUSINESS

Trick and Treat

- **TRICK**: 
  - Adding transfer restrictions after the fact
  - Rescission offers or broken trades
  - Reputational damage, annoyance and uncertainty
  - Fines or other enforcement action from the SEC
- **TREAT**: 
  - Assign ownership for tracking usage under both Form S-3 and Form S-8 registration statements and under the plan
  - If you use third-party service providers, be sure you understand what they track, monitor it closely, and include checks in your internal control procedures

Missing the NYSE Record Date Notice

- NYSE-listed companies are required to notify the NYSE at least **10 calendar days** in advance of all record dates
  - An NYSE-listed company that ***changes*** a record date must provide another advance notice to the NYSE of at least 10 calendar days
  - An NYSE-listed company's publication of a record date by means of a press release or SEC filing does **not** constitute notice to the NYSE
- Section 204 of the NYSE Listed Company Manual establishes the methods for companies to provide record date notice:
  - For cash and stock distributions, record date notifications should be submitted electronically through Listing Manager or emailed to the Exchange (dividend@nyse.com)
  - For shareholder meetings, record date notifications should be submitted through Listing Manager or be emailed to the Exchange (proxyadmin@nyse.com)
- Note that the NYSE will **not** be forgiving if companies forget to/do not follow this rule and will make companies move their meeting dates

Trick and Treat

- **TRICK**: 
  - Moving a record date can cause a waterfall effect, meaning a company has to adjust its broker search, mail date, and potentially the meeting date
- **TREAT**: 
  - Make sure that the NYSE notification is included on the annual meeting checklist
  - Make a habit of notifying the NYSE on the day the board approves the record date, rather than waiting until 10 days before the record date

Missing the Say-When-On-Pay Vote (or the related Form 8-K)

- Rule 14a-21 of the Exchange Act:
  - Requires non-binding say-on-pay proposal at least every **three** years
  - Requires separate non-binding proposal on whether the say-on-pay vote should occur every one, two, or three years (say-when-on-pay votes) at least every **six** years
- Form 8-K Item 5.07 requires companies to disclose their decision as to how frequently they will conduct say-on-pay votes following each shareholder say-when-on-frequency vote no later than **150 calendar days** after the end of the meeting at which the vote was taken

Trick and Treat

- **TRICK**: 
  - Missing a say-when-on-pay vote can expose a company to potential SEC enforcement action and plaintiff interest
  - At the very least, this represents a disclosure controls and procedures issue
  - Missing the Form 8-K requirement to report how the company has decided to handle the results of the vote can cause loss of S-3 eligibility
- **TREAT**: 
  - Make sure your proxy states when the next say-when-on-pay vote will occur

Unexpected Cockroaches: Losing S-3 Eligibility

Form S-3 Eligibility

- Use of Form S-3 is a **privilege, not a right**, and it comes with certain requirements:
  - Must be "timely" in filing 10-Ks, 10-Qs, proxies and Form 8-Ks during the twelve calendar months and any portion of a month immediately preceding the filing of the Form S-3 (with certain 8-K exceptions)
  - "Timely" means cannot be missed or late

> *"Registrants must meet the following conditions in order to use this Form S-3 for registration under the Securities Act of securities offered in the transactions specified in I. B. below: . . . 3. The registrant: . . . (b)* ***has filed in a timely manner all reports*** *required to be filed during the twelve calendar months and any portion of a month immediately preceding the filing of the registration statement, other than a report that is required solely pursuant to Item 1.01, 1.02, 1.04, 1.05, 2.03, 2.04, 2.05, 2.06, 4.02(a) or 5.02(e) of Form 8-K (§249.308 of this chapter). If the registrant has used (during the twelve calendar months and any portion of a month immediately preceding the filing of the registration statement) Rule 12b-25(b) (§240.12b-25(b) of this chapter) under the Exchange Act with respect to a report or a portion of a report, that report or portion thereof has actually been filed within the time period prescribed by that rule."*

CEO and CFO Certification Mistakes

- Pursuant to Sections 302 and 906 of Sarbanes-Oxley, CEOs and CFOs are required to provide two separate certifications as exhibits to a company's periodic reports under Item 601 of Regulation S-K
  - These certifications are Exhibits 31 (Section 302) and 32 (Section 906) on Form 10-K and 10-Q
- If the certifications are omitted from the originally filed report, the refiled report will be considered delinquent if it is not filed before the report deadline, thereby causing the company to lose S-3 eligibility
- Certifications that are timely filed but are missing certain information will be considered filed timely for purposes of S-3 eligibility, so a company will be deemed current even though it still needs to file an amended report containing the corrected certifications

CEO and CFO Certification Mistakes

The following errors would require a company to file a corrected Exhibit 31 (and probably Exhibit 32) certification that is accompanied by the *entire* periodic report:

1. The company identifies the wrong periodic report in paragraph 1 of the certification;
2. The certification omits a conformed signature above the signature line at the end of the certification;
3. The certification fails to include a date; and
4. The individuals who sign the certification are neither the company's principal executive officer nor the principal financial officer, or persons performing equivalent functions

***See* C&DI 246.14.**

Exhibit 31.1

Rule 13a-14(a) Certification of Chief Executive Officer

I, Christopher J. Kempczinski, certify that:

(1) I have reviewed this quarterly report on Form 10-Q of McDonald's Corporation;

(2) Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

(3) Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

(4) The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

(a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

(c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

(5) The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 2, 2023

/s/ Christopher J. Kempczinski

Christopher J. Kempczinski

President and Chief Executive Officer

CEO and CFO Certification Mistakes

Exhibit 32.1

Certification pursuant to 18 U.S.C. Section 1350 by the Chief Executive Officer, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (subsections (a) and (b) of Section 1350, Chapter 63 of Title 18, United States Code), the undersigned officer of McDonald's Corporation (the "Company"), does hereby certify, to such officer's knowledge, that the Quarterly Report on Form 10-Q for the quarter ended June 30, 2023 of the Company fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and information contained in the Form 10-Q fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: August 2, 2023

/s/ Christopher J. Kempczinski

Christopher J. Kempczinski

President and Chief Executive Officer

Trick and Treat

- **TRICK**: 
  - Late periodic reports means a company loses ability to file new or use existing Form S-3s (and loses WKSI status) for at least 12 months
  - As a result, companies may need to refile existing registration statements or delay planned financing
  - This means there may also be a potential disclosure controls issue
- **TREAT**: 
  - Double and triple-check the certifications for each filing
  - Check the as-filed version to make sure the certifications were correctly filed

Missed Form 8-Ks

- As a default, Form 8-K must be filed within **four business days** after the occurrence of a reportable event

Filing Deadlines	
Day of Occurrence	**Filing/Furnishing Deadline***
Monday	Friday
Tuesday	Monday
Wednesday	Tuesday
Thursday	Wednesday
Friday	Thursday
Saturday	Thursday
Sunday	Thursday

*not including Federal holidays

Timing Note: There are various limited exceptions to the four-business-day rule, but the most frequent are:

- Item 2.02 8-Ks (*Earnings Releases*) should always be filed PRIOR to the earnings call
- Item 7.01 8-Ks (*Regulation FD*) have to be filed within the time periods specified in that rule

Form 8-K Reportable Events (non-safe harbored 8-K requirements in orange)	
Section 1: Business and Operations	
Item 1.01	Entry into Material Definitive Agreement
Item 1.02	Termination of Material Definitive Agreement
Item 1.03	Bankruptcy or Receivership
Item 1.04	Mine Safety – Reporting of Shutdowns and Patterns of Violations
Item 1.05	Cybersecurity Incidents
Section 2: Financial Information	
Item 2.01	Completion of Acquisition or Disposition of Assets
Item 2.02	Results of Operations and Financial Condition
Item 2.03	Creation of a Direct Financial Obligation or an Obligation under an Off-Balance Sheet Arrangement of a Registrant
Item 2.04	Triggering Events That Accelerate or Increase a Direct Financial Obligation or an Obligation under an Off-Balance Sheet Arrangement
Item 2.05	Costs Associated with Exit or Disposal Activities
Item 2.06	Material Impairments
Section 3: Securities and Trading Markets	
Item 3.01	Notice of Delisting or Failure to Satisfy a Continued Listing Rule or Standard; Transfer of Listing
Item 3.02	Unregistered Sales of Equity Securities
Item 3.03	Material Modification to Rights of Security Holders
Section 4: Matters Related to Accountants and Financial Statements	
Item 4.01	Changes in Certifying Accountant
Item 4.02	Non-Reliance on Previously Issued Financial Statements or a Related Audit Report or Completed Interim Review
Section 5: Corporate Governance and Management	
Item 5.01	Changes in Control of Registrant
Item 5.02*	Departure of Directors or Principal Officers; Election of Directors; Appointment of Principal Officers
Item 5.03	Amendments to Articles of Incorporation or Bylaws; Change in Fiscal Year
Item 5.04	Temporary Suspension of Trading under Registrant's Employee Benefit Plans
Item 5.05	Amendments to the Registrant's Code of Ethics, or Waiver of a Provision of the Code of Ethics
Item 5.06	Change in Shell Company Status
Item 5.07	Submission of Matters to a Vote of Security Holders
Item 5.08	Shareholder Director Nominations
Section 7: Regulation FD	
Item 7.01	Regulation FD Disclosure
Section 8: Other Events	
Item 8.01	Other Events
Section 9: Financial Statements and Exhibits	
Item 9.01	Financial Statements and Exhibits

*Item 5.02 (Executive Officers and Directors): Only Item 5.02(e) (*Compensatory Arrangements*) is within the safe harbor. Appointment/resignation of directors and executive officers is NOT within the safe harbor

Trick and Treat

- **TRICK**: 
  - Certain late Form 8-Ks mean a company loses its ability to file new or use existing Form S-3s (and loses WKSI status) for at least 12 months
  - As a result, companies may need to refile existing registration statements or delay planned financing
  - This means there may also be a potential disclosure controls issue
- **TREAT**: 
  - Implement a written resignation requirement in the bylaws or corporate governance guidelines
  - Implement training and disclosure controls

Evil Clowns: Plaintiff's Bar Areas of Interest

Short-Swing Liability

- Requirement for directors, executive officers and significant stockholders to disgorge to the Company profits realized upon the purchase and sale, or sale and purchase, of Company equity securities within a six-month period
  - Strict liability statute
  - Active plaintiffs' bar
  - Rule 10b5-1 plans do not provide protection
- Most common exemptions from Section 16(b):
  - Transactions between the Company and the officers or directors if properly approved (Rule 16b-3)
  - Bona fide gifts and inheritances (Rule 16b-5)
- **Transfers to watch out for**:
  - Household trades
  - Estate planning

Trick and Treat

- **TRICK:** 
  - Plaintiff firms detect matching trades and send demand letters as quickly as possible following Form 4 filings
  - This requires going to an executive or director and asking them to write the company a check
  - Could result in payment of legal fees related to handling plaintiff firm demands

- **TREAT**: 
  - Implement a strong preclearance checklist
  - Educate directors and Section 16 officers that any movement in their stock — including estate planning, changes in trustees, etc. must be precleared in advance

Voting Standard Disclosure and Counting Mistakes

- Item 21 of Schedule 14A requires companies to disclose in their proxy statements for each matter submitted to a vote of shareholders:
  - The vote required for approval of each matter submitted for a vote of shareholders
  - The method by which votes will be counted, including the treatment and effect of abstentions and broker non-votes, and to the extent applicable, a shareholder's withholding of authority to vote for a nominee
- The voting standards applicable to the items on the agenda may come from state law, stock exchange rules, or a company's governing documents depending on a variety of factors
- The effect of abstentions, withheld votes, and broker non-votes also depends on the applicable voting standards and various other factors (*e.g.*, is there a "routine" item on the agenda?)

Voting Standard Disclosure and Counting Mistakes

Are You a Zombie?

1. What is the effect of abstentions and broker non-votes where the voting standard for a matter (other than a director election) at a Delaware-incorporated company's annual meeting is ***majority in voting power of the shares present in person or represented by proxy and entitled to vote on the matter***?

   (a) Both no effect

   (b) Both have the same effect as against

   (c) Abstentions have the same effect as against; broker non-votes have no effect

   (d) Broker non-votes have the same effect as against; abstentions have no effect

   (e) I have no idea

2. What is the effect of abstentions and broker non-votes where the voting standard for a matter (other than a director election) at a Delaware-incorporated company's annual meeting is ***majority in voting power of the shares present in person or represented by proxy and entitled to vote thereat***?

   (a) Both no effect

   (b) Both have the same effect as against

   (c) Abstentions have the same effect as against; broker non-votes have no effect

   (d) Broker non-votes have the same effect as against; abstentions have no effect

   (e) I have no idea

Trick and Treat

- **TRICK**: 
  - If discovered prior to vote, this involves supplementing the proxy and paying the plaintiff's firm a fee for their services
  - There could have more adverse implications if this is discovered after the vote is implemented
- **TREAT**: 
  - Submit your proxy proposals to the NYSE prior to filing, and they will weigh in on "routine" and "non-routine" matters for broker non-vote purposes for both NYSE and NASDAQ issuers
  - Ensure the language in the proxy directly tracks the language of the voting standard in the applicable stock exchange rule, bylaw, charter provision, or state law
  - Work with your favorite securities lawyer to review

Monsters Under the Bed: Enforcement Areas of Interest

Related Party Transaction Disclosure Violations

- Companies are required to disclose information about transactions involving the company and its directors, executive officers and other enumerated parties in proxy statements or on Form 10-Ks
- Pursuant to Item 404 of Regulation S-K, transactions that must be disclosed include any transaction since the beginning of the company's latest fiscal year, or any currently proposed transaction, in which:
  - the company was — or is to be — a participant;
  - the amount involved in the transaction exceeds $120,000; and
  - any "related person" had — or will have — a direct or indirect material interest
- When a related party transaction must be disclosed, the company must describe the transaction, including:
  - the related person's name and relationship to the company;
  - the related person's interest in the transaction with the company, including the related person's position or relationship with, or ownership in, a firm, corporation, or other entity that is a party to — or has an interest in — the transaction;
  - the approximate dollar value of the transaction and of the related person's interest in the transaction; and
  - any other information regarding the transaction or the related person in the context of the transaction that is material to investors considering the circumstances of the particular transaction

Related Party Transaction Disclosure Violations

- On September 18, 2023, the SEC announced settled charges with Lyft for failing to disclose one of its director's role in a large shareholder's private sale of approximately $424 million of shares of Lyft prior to Lyft's IPO
  - The director arranged for a shareholder to sell its shares to a special purpose vehicle set up by an investment adviser affiliated with the director, and also contacted an investor interested in purchasing the shares
  - The director received millions in compensation from the investment adviser
  - Lyft approved the sale and secured terms in the contract, but the director did not disclose his compensation or material interest in the transaction to Lyft, so it did not disclose the information regarding the sale in its Form 10-K
  - Lyft agreed to a cease-and-desist order and to pay a $10 million civil penalty
- On September 11, 2023, the SEC announced settled charges against Maximus for failing to make disclosures related to Maximus's employment of the siblings of one of its executive officers
  - The executive officer was a longtime employee of the Company before being appointed to executive officer; the siblings were also longtime employees that each received annual compensation of more than $120,000
  - Maximus' Form 10-Ks and proxy statements filed in the fiscal years between appointing the employee to executive officer (2019) and 2022 did not disclose this information
  - Maximus agreed to pay a civil penalty of $500,000

SEC Charges Maximus for Reporting and Proxy Violations

SEC Charges Lyft with Failure to Disclose Board Member's Financial Interest in Private Shareholder's Pre-IPO Stock Transaction

Trick and Treat

- **TRICK**: 
  - Potential enforcement action and fines
- **TREAT**: 
  - Make sure D&O questionnaires are targeted and review responses closely

Section 16 Reporting Issues

- **Section 16(a):** Requirement to file reports regarding transactions in and holdings of Company equity securities
- Who is subject to Section 16?
  - Directors
  - "Officers" (as defined in Rule 16a-1(f))
    - Includes the principal accounting officer/controller
  - Greater than 10% beneficial owners

- Reporting Persons file three kinds of reports:
  - **Form 3:** Initial Statement of Beneficial Ownership
    - Filed within 10 days of becoming a "Reporting Person"
  - **Form 4:** Statement of Changes in Beneficial Ownership
    - Filed before the end of the second business day following the day on which the transaction resulting in a change of pecuniary interest was executed
    - Pursuant to the SEC's new rules adopted December 14, 2022, bona fide gifts of equity securities previously reported on Form 5 are now required to be reported on Form 4
  - **Form 5:** Annual Statement of Beneficial Ownership
    - Filed within 45 days of fiscal year-end
    - Insider must file a Form 5 unless insider had no reportable transactions during the year or already filed one or more Forms 4 during the year covering all transactions required to be reported on Form 4 or 5

Section 16 Reporting Issues

- On September 27, 2023, the SEC announced that it entered cease and desist orders against five companies and six individuals based on violations of Section 16(a), Section 13(d) and Item 405 disclosure obligations occurring (mostly) between 2017 and 2022
- Each company swept up in the enforcement actions was charged with "causing" Section 16(a) violations by undertaking to assist insiders with section 16(a) reporting requirements but failing to do so
- Three of the five companies were also charged with violating proxy and Form 10-K disclosure requirements for failing to disclose insiders' reporting violations pursuant to Item 405 of Regulation S-K
- Four of the individuals were directors or officers and were charged with violating Section 16(a) (*i.e.*, failures to timely file Forms 4 and 5)
- The SEC's press release described the investigation as "ongoing," hinting that there may be more charges to come

SEC Charges Corporate Insiders for Failing to Timely Report Transactions and Holdings

Several issuers charged as well in connection with their insiders' reporting failures

FOR IMMEDIATE RELEASE
2023-201

- Nicole M. Fernandez-McGovern, CFO of AgEagle Aerial Systems Inc., $125,000;
- Matthias L. Heilmann, former President and Chief Executive Officer of Digital Solutions within Baker Hughes Co., $143,000;
- Joseph Theodore Lukens, Jr., a beneficial owner of Workhorse Group Inc., $120,000;
- Avery More, a director of SolarEdge Technologies, Inc., $66,000;
- Lawrence I. Rosen, a beneficial owner of JAKKS Pacific, Inc., Meet Group Inc., FTE Networks, Inc., FuelCell Energy Inc., and Remark Holdings Inc., $150,000; and
- Peixin Xu, a director and beneficial owner of Cineverse Corporation, $150,000.
- AgEagle Aerial Systems Inc., $190,000;
- Cumberland Pharmaceuticals Inc., $200,000;
- eXp World Holdings, Inc., $115,000;
- Lattice Semiconductor Corporation, $185,000; and
- SolarEdge Technologies, Inc., $125,000.

Trick and Treat

- **TRICK**: 
  - Item 405 disclosure in the proxy statement
  - Enforcement interest beyond just the short-swing trading liability
- **TREAT**: 
  - Implement a strong preclearance checklist
  - Educate directors and Section 16 officers that any movement in their stock — including estate planning, changes in trustees, etc. must be precleared in advance

"Timely disclosure of insider stock transactions is a fundamental component of the federal securities laws that ensures the fair operation of our securities markets," said Sheldon L. Pollock, Associate Regional Director of the SEC's New York Regional Office. "CEOs should assume that the use of an offshore account will not prevent the staff of the SEC from identifying manipulative trading."

Insider Trading and Rule 10b5-1

- Insider Trading
  - Transacting in (*e.g.*, buying, selling, gifting) securities in breach of a fiduciary duty/relationship of trust while possessing material, nonpublic information, with scienter (knowledge or recklessness)
  - Can include "tipping off" third-parties
- Key Definitions:
  - Material information: Information that is substantially likely to influence a reasonable investor
  - Nonpublic information: Information that has not been publicly disseminated; can include information about other companies (not just employer)
  - Insider: Ranges from a director, officer or significant shareholder to someone with no direct fiduciary duty to the company but who would violate a contract or policy
  - Fiduciary duty, relationship of trust or confidence, or other breach of duty: Requirement for discretion and confidentiality based on a party's involvement in the situation
- **Rule 10b5-1(c)** gives an **affirmative defense** to:
  - People & companies who trade securities under a pre-written plan; entered in good faith; and when individual does not possess material, nonpublic information
  - Use of a 10b5-1 plan is an affirmative defense, but failure to satisfy all of the conditions of the rule voids the defense and leaves the company and the holder vulnerable

Shadow Insider Trading and *SEC v. Panuwat* (2022)

Shadow Insider Trading: The use of non-public confidential information about one company to trade or purchase the securities of another closely correlated company.

- ***S.E.C. v. Panuwat*** (N.D. Cal. 2022)
  - Panuwat was an employee at a company called Medivation who signed a confidentiality agreement and the company's insider trading policy
  - Panuwat learned that Medivation would be acquired, which would likely cause the stock price of Incyte, a similar company in the same industry, to increase dramatically. He then used this information to purchase Incyte call option contracts, making a profit of $107,066
  - The SEC charged Panuwat with insider trading in violation of Section 10(b) and Rule 10b-5, arguing that he misappropriated confidential, non-public information about Medivation to trade in the securities of a competing company, Incyte
  - The SEC is arguing that Panuwat had a duty not to trade in Incyte's stock because the Medivation insider trading policy prohibited him from using material, non-public information obtained through his work to trade in "the securities of another publicly traded company, including all significant collaborators, customers, partners, suppliers, or competitors of the Company"
  - The Northern District of California denied Panuwat's motion, finding that the SEC made a sufficient showing to advance the case and that the SEC's new theory fell within the contours of the misappropriation theory and the language of the applicable law, relying in part on the wording of Medivation's insider trading policy

Trick and Treat

- **TRICK**: 
  - The SEC is pursuing novel arguments for insider trading liability
  - Developments in technology allow the SEC to monitor successful trades
  - Insider trading cases get a lot of attention
- **TREAT**: 
  - Training and implementation of an insider trading policy and blackout periods
  - Preclearance of Rule 10b5-1 plans and any amendments to those plans
  - Consider whether it is appropriate for your insider trading policy to cover trades in other third-party companies

Restatement Issues

- Common Causes of Restatement
  - Errors made in the calculation of specific types of taxes and credits
  - Changes in valuation allowances
  - Improper classification of current and non-current deferred tax assets
  - Errors in the calculation of the tax effects of stock-based compensation
  - Errors in purchase accounting adjustments and goodwill impairment calculations
  - Incorrect revenue recognition

- Results from Restatement Analysis
  1. Reissuance restatements (or “big R” Restatement)
     - Errors in previously issued financial statements are corrected — restated — and reissued
     - Involve amendment of previous SEC filings or “Super 10-K” filing
     - Often involve withdrawal of reliance on prior financial statements
     - Often, but not always, involve late periodic reports while possible restatement is under evaluation
  2. Revision restatements (or “little r” restatement)
     - Recast past information in current reports, such as for discontinued operations, changes in accounting principles, or to correct accounting errors not material enough to merit reissuance restatement
     - Sometimes involve late periodic reports while possible restatement is under evaluation
  3. No restatement
     - May still involve material weakness disclosure

Restatement Issues

- Clawbacks
  - The new NYSE / Nasdaq listing rules require companies to adopt written policies that “clawback” erroneously awarded incentive-based compensation to current and former Section 16 officers in the event of “Big R” or “little r” accounting restatements
- Late Filings
  - Big R Restatements can often (but not always), and little r restatements can sometimes, cause late periodic reports due to the time that possible restatement is under evaluation
  - Late filers will lose S-3 eligibility
- SEC Investigations
  - In 2022, the SEC brought 91 enforcement actions relating to company reporting and audit & accounting matters. This was 12% of all actions brought by the Division of Enforcement
  - Because of limited resources, the SEC looks to information disclosed by companies that might evidence fraud
  - The SEC has consistently identified restatements, along with whistleblowers, internal and external referrals, and company self-reports as ways that the Division of Enforcement has historically learned of potential violations of the federal securities laws
  - Companies that initiate an internal investigation in response to accounting issues evidenced in a restatement and promptly begin a remediation program can obtain a better result in an enforcement action

Trick and Treat

- **TRICK**: 
  - Restatements are really all tricks:
    - Potential late filings and loss of S-3 eligibility
    - Area of interest for enforcement
    - Clawback policies mean that executive compensation is at risk
- **TREAT**: 
  - Implement a clawback policy by December 1, 2023

The Call is Coming from Inside the House: Part 205

Overview

- When an attorney appearing and practicing before the SEC in the representation of a company becomes aware of evidence of a material violation, the attorney must:
  - Report the evidence to the company's chief legal officer ("CLO")
    - If the CLO reasonably believes there is no material violation, they must notify the reporting attorney with an explanation
    - Otherwise, the CLO must:
      - Take all reasonable actions to cause the company to adopt an appropriate response
      - Advise the reporting attorney of such steps
  - If the reporting attorney believes the CLO did not provide an appropriate response, the reporting attorney must report "up the ladder" to the audit committee, another committee of the board consisting entirely of non-employee directors, or the full board

Overview

- "Appearing and practicing before the SEC" includes:
  - Transacting any business with the SEC
  - Representing a company in any SEC administrative proceeding or in connection with any SEC investigation, inquiry, information request or subpoena
  - Providing advice on U.S. securities laws regarding any document that the attorney has notice will be filed with or submitted to the SEC or incorporated by reference in an SEC filing
  - Advice given in the context of preparing or participating in preparing any such document
  - Advising whether any information, statement, opinion or other writing is required to be filed with the SEC
  - Note, Part 205 is applicable not only to securities lawyers but also to *other lawyers who would not ordinarily regard themselves as candidates* for regulation by the SEC

Overview

- Evidence is “credible evidence, based upon which it would be unreasonable, under the circumstances, for a prudent and competent attorney not to conclude that it is reasonably likely that a material violation has occurred, is ongoing or is about to occur”
- A material violation includes:
  - A material violation of the securities laws
  - A breach of fiduciary duty
  - A similar material violation
- Covered material violations include those by the company or by any officer, director, employee or agent of the company
- Supervisory Attorney Responsibilities
  - A “supervisory attorney” supervises/directs other attorneys appearing and practicing before the SEC (this includes a company’s Chief Legal Officer)
  - Supervisory attorneys must take responsible efforts to ensure that subordinate attorneys comply with SEC rules
  - Supervisory attorneys also must comply with the reporting requirements of Rule 205 when a subordinate attorney reports evidence of a material violation

Trick and Treat

- **TRICK**:
  - Violations of Part 205 subject attorneys to civil (but not criminal) penalties and remedies available to the SEC for violations of U.S. federal securities laws

- **TREAT**: 
  - Both lawyers and public companies should establish procedures to implement compliance with Part 205
  - Law firms and law departments within public companies should have adopted formal procedures for reporting and consulting with respect to potential violations by issuers to determine if action is required to comply with Part 205

THANK YOU

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