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PUBLIC COMPANY ALERT

To: All Clients

Re: ISSUERS AND CORPORATE INSIDERS SHOULD REVISIT PROCEDURES FOR REPORTING OWNERSHIP IN VIEW OF SEC'S ANNOUNCEMENT OF ENFORCEMENT PROCEEDINGS

On September 10, 2014, the SEC made the unprecedented announcement that it had initiated enforcement proceedings against 29 corporate insiders and 7 public companies for violations of the Securities Exchange Act relating to late or deficient filings of Section 16(a) ownership reports (Forms 3, 4, 5) and Section 13 reports (Schedules 13D, 13G). See [*SEC Announces Charges Against Corporate Insiders for Violating Laws Requiring Prompt Reporting of Transactions and Holdings \(Sep. 10, 2014\)*](#); [*SEC Announces Fraud Charges Against Biotech Company and Former Executive Who Failed to Report Insider Stock Sales \(Sep. 10, 2014\)*](#).

The SEC enforcement initiative focused on two types of ownership reports: the Form 4, which corporate officers, directors, and certain beneficial owners of more than 10 percent of a registered class of a company's stock must use to report their transactions in company stock within two business days; and Schedules 13D and 13G, which beneficial owners of more than 5 percent of a registered class of a company's stock must periodically use to report holdings or intentions with respect to the company.

Traditionally, the SEC has not pursued these cases unless they were tied to significant wrongful activity such as insider trading and participating in pumps and dumps and other manipulative schemes. While much of the conduct underlying the proceedings announced September 10, 2014, took place over an extended period of time and involved multiple missed or late filings, only one of these proceedings alleged fraudulent misconduct. The SEC's current approach is part of the "broken windows" policy announced by Chair Mary Jo White in October 2013: "we are looking for the "broken windows" in our markets – and not overlooking the small violations to avoid breeding an environment of indifference to our rules." See Mary Jo White, [*Remarks at Securities Enforcement Forum \(Oct. 13, 2013\)*](#).

Although the responsibility for filing Form 4s and Schedule 13Ds and 13Gs generally falls upon the corporate insiders and not the company (although some issuers assist in the preparation of these

forms), issuers are required make representations regarding the beneficial ownership of corporate insiders and 5 percent beneficial owners in annual reports, registration statements, prospectuses and proxy statements. Issuers must also disclose in annual reports and proxy statements any known late filings and failures by any insider to make required Section 16(a) filings. In these proceedings, several of the issuers took on the responsibility of assisting officers and directors with preparing and filing ownership reports and were aware of late filings but did not disclose them in annual reports and proxy statements. The issuers allegedly could also have learned of the often chronic late filings by reviewing the Form 4s filed by officers and directors, but did not do so.

Penalties in the settled cases range from \$25,000 to \$175,000 for individuals, \$64,000 to \$120,000 for institutional investors, and \$75,000 to \$375,000 for issuers.

These proceedings indicate a new enforcement direction. Having publicized this first wave, it can be expected that the SEC will seek to impose harsher sanctions in future enforcement proceedings.

Under these circumstances, we recommend that issuers take the following steps to ensure that their practices conform to SEC requirements:

- Review policies and practices for gathering beneficial ownership information from officers and directors.
- Consider the most effective way to communicate SEC filing requirements to officers and directors. If the information is contained in a lengthy insider trading policy, consider circulating a stand-alone communication.
- Generally, company insider trading policies require preclearance of all trades. These policies must be complied with and enforced. Late filings of Form 4s may signal that the insider trading policy has not been followed.
- Where officers and directors have a 10b5-1 plan, make sure a procedure is in place to ensure that officers and directors receive timely notification after sales so Form 4s can be filed within the required time period.
- Officers and directors must report grants of stock and options. A best practice is for the company to remind officers to make the necessary filings at the time of the award, and each stock or option grant should be accompanied by an agreement or letter from the company that includes a filing reminder.
- Incorporate checks and balances into the issuer's procedures for obtaining information about beneficial ownership. Where officers and directors have a pattern of late or missing filings, it is probably not reasonable to rely on a D&O questionnaire without further documentary backup. Likewise, securities held in street name and options are not reflected on transfer agent records.
- Prepare the proper and complete disclosures in the annual report early enough to avoid making errors.

There can be many technical questions associated with meeting these filing requirements, and it is recommended that you consult with counsel when making these filings. Furthermore, there is strict



liability for violations of Section 16(b) for “short swing profits” made within a six-month period, and all such profits must be disgorged to the issuer. Compliance with insider trading policies can prevent this liability.

For questions about filing requirements, please contact [David Selengut \(selengut@egsllp.com\)](mailto:selengut@egsllp.com).

For questions about SEC enforcement proceedings and securities litigation, please contact [Adrienne Ward \(award@egsllp.com\)](mailto:award@egsllp.com).

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