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The Corporate & Securities Law Advisor

VOLUME 37, NUMBER 12, DECEMBER 2023

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Separate from "pure play" activist hedge funds, the changes could also alter the landscape for potential acquirers who use a minority stake as a foothold in an acquisition strategy—albeit a complex strategy with the interplay of shareholder rights plans and other factors. Such investors may start as a "passive investor" who must flip from Schedule 13G to Schedule 13D if they develop "control intent" with respect to a given company.

Investors who hold equity stakes from 5 percent–19.9 percent qualify for the "short form" Schedule 13G so long as they are "passive" and do not have "control intent" through actions such as advocating for board changes or a change of control process/acquisition intent. If a "passive investor" develops "control intent" and seeks to consummate an acquisition transaction with the company, the new timeline reduces the amount of time to proceed from developing control intent to inking an acquisition contract before required public disclosure of intent on a Schedule 13D.

Notes

1. *https://www.sec.gov/files/rules/final/2023/33-11253.pdf.*
2. *https://www.sec.gov/files/rules/final/2023/34-97656.pdf.*

SEC Charges Companies and Insiders for "Ongoing" Investigation of Beneficial Ownership Reporting Violations

By Josh La Grange and Nathan M. Erickson

On September 27, 2023, the Securities and Exchange Commission (SEC or Commission) announced the settlement of administrative cease-and-desist orders with six separate corporate insiders regarding failures to timely report information about their holdings and transactions in company securities under Sections 13(d) and/or 16(a) of the Securities Exchange Act of 1934.[1] The SEC also announced that it had entered into settlements with five publicly-traded companies concerning their failures to comply with the disclosure requirements of Item 405 of Regulation S-K (which requires issuers to annually disclose insiders' failures to file any of the Forms 3, 4 and 5 required by Section 16(a) on a timely basis), and/or their roles in "causing" reporting violations by their insiders.[2] The Commission attributed its discovery of the underlying disclosure violations to "data analytics."

In announcing the orders, the Commission delivered a clear message that these "enforcement action[s] should serve to remind SEC filers that reporting obligations under the securities laws are not optional, and there are consequences for failing to file required forms in a timely manner."

Focus of the Investigations and Settled Orders

The charges announced, which echoed a 2014 sweep,[3] were primarily focused on recidivist late filers who were often late by weeks or months, or even years. For example, in one representative settled order, the SEC alleged that a public company officer failed to timely file a Form 4 or Form 4 amendment under Section 16(a) on 36 separate occasions over the course of 2018–2022. The late filings allegedly

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included sales on seven dates between January 2021 and June 2021 with an aggregate market value of approximately $1.38 million, none of which were reported until October 1, 2021.[4] In a separate settled order with the officer's public company employer, the SEC alleged that the issuer had failed to make accurate Item 405 disclosures over four separate years, and was "a cause" of certain violations by its insiders of Section 16(a) and Rule 16a-3 thereunder.[5]

In this order (and the other comparable orders), the SEC's allegations that the issuer was "a cause" of its insiders' violations of Section 16(a) and Rule 16a-3 thereunder were based on the issuer's negligence in assisting its officers and directors with filing their Section 16(a) reports. Although such assistance is voluntary, it is a widespread practice among public companies. While the Commission acknowledged that "insiders remain responsible for the timeliness and accuracy of their required Section 16(a) reports," it nonetheless concluded that "issuers who voluntarily accept certain responsibilities and then act negligently in the performance of those tasks may be liable as a cause of Section 16(a) violations by insiders."

With respect to Item 405, the SEC alleged that in some years the issuer respondent "did not possess any written representations from its officers and directors" that a Form 5 filing was not required, and "did not have a basis to know" that such filings were not required for certain insiders.[6] In other instances, the Commission alleged that, although the issuer disclosed the names of individuals that it believed had not timely complied with their Section 16(a) reporting obligations, the issuer's disclosure suffered from material deficiencies and omissions, including "failing to set forth for each named insider the number of late reports and the number of transactions that were not reported on a timely basis."

The SEC also alleged that, although Item 405 disclosure does not require the type of transactions covered to be set forth, in one instance, the issuer's disclosure inaccurately described the type of transactions covered by the untimely reports. In this particular matter, the public company and its former officer each agreed to a settled cease-and-desist order and to pay civil penalties of $190,000 and $125,000, respectively.

The settled orders also make it clear that the SEC may attribute liability to the issuer for "causing" Section 16(a) and Rule 16a-3 violations even in the absence of issuer Item 405 violations. For example, in one settled order, the SEC alleged that an issuer had caused violations by its officers and directors, who collectively filed untimely Section 16(a) reports for reportable transactions that occurred on more than 90 dates between January 2018 and March 2022.[7]

The Commission's order found that the issuer had in almost all instances "received timely notification of or otherwise possessed the necessary information for such filings but failed to prepare and file the reports within the required time frame." As a result, notwithstanding the issuer's Item 405 disclosure of these late filings, the SEC concluded that the issuer's procedures and practices were "insufficient to the extent that those practices resulted in the recurrent failure to meet the two-business day filing deadline."[8]

While the majority of the settled administrative orders announced by the SEC concerned late filings pursuant to Section 16(a), the SEC also charged several individuals with violating their disclosure obligations under Section 13(d). In one of these matters, the SEC charged a director and greater-than-10 percent beneficial owner with violating both Sections 13(d) and 16(a), as well as Rules 13d-2 and 16a-3 thereunder.

The respondent in this matter was alleged to have untimely filed Forms 4 or Forms 4 amendments on 36 separate occasions, typically up to a month or more after the due dates.[9] The late Section 16 filings allegedly covered more than $20 million in open-market and privately-negotiated sales between September 2020 and December 2022 and approximately $22 million in acquisitions from the issuer through stock purchase agreements or loan conversions. The respondent also was alleged to have violated Rule 13d-2 on multiple occasions by failing to file timely amendments upon the acquisition or

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disposition of more than 1 percent of the issuer's outstanding shares of equity securities.[10] In addition to agreeing to a cease-and-desist order, the respondent agreed to pay a civil monetary penalty of $150,000.

Takeaways

The SEC characterized these settlements as part of an "ongoing investigation of potential beneficial ownership violations," suggesting that the staff of the SEC's Enforcement Division may be focused on further potential enforcement actions in this space.[11] Invoking "data analytics" emphasizes that the investigatory tools available to the Commission have evolved.

In explaining its enforcement focus and resources, and highlighting its views on issuer liability, the SEC offers a caution and reminder to public companies and their insiders regarding the importance of maintaining robust compliance procedures in support of timely reporting under the beneficial ownership reporting provisions of the federal securities laws. For example, public companies should consider obtaining annual written representations from their insiders with respect to Section 16 filings (in connection with or in addition to D&O questionnaires for the annual proxy statement), if that is not already their practice. Companies that voluntarily assist their directors and officers with Forms 3, 4 and 5 filings may wish to further provide those insiders with a schedule of transactions and filings for the prior fiscal year, on an annual basis, for the insiders' confirmation of accuracy and completeness.

Notes

1. *See* Litigation Rel. No. 2023-201, *SEC Charges Corporate Insiders for Failing to Timely Report Transactions and Holdings* (Sept. 27, 2023), *available at https://www.sec.gov/news/press-release/2023-201*. *See also, In the Matter of Joseph Theodore Lukens, Jr.*, Exchange Act Rel. No. 98542 (Sept. 27, 2023); *In the Matter of Avery More*, Exchange Act Rel. No. 98543 (Sept. 27, 2023); *In the Matter of Nicole M. Fernandez-McGovern*, Exchange Act Rel. No. 98546 (Sept. 27, 2023); *In the Matter of Matthias L. Heilmann*, Exchange Act Rel. No. 98547 (Sept. 27, 2023); *In the Matter of Lawrence I. Rosen*, Exchange Act Rel. No. 98545 (Sept. 27, 2023); and *In the Matter of Peixin Xu*, Exchange Act Rel. No. 98550 (Sept. 27, 2023).
2. *See In the Matter of Lattice Semiconductor Corp.*, Exchange Act Rel. No. 98548 (Sept. 27, 2023); *In the Matter of SolarEdge Technologies, Inc.*, Exchange Act Rel. No. 98549 (Sept. 27, 2023); *In the Matter of eXp World Holdings, Inc.*, Exchange Act Rel. No. 98551 (Sept. 27, 2023); *In the Matter of AgEagle Aerial Systems Inc.*, Exchange Act Rel. No. 98552 (Sept. 27, 2023); and *In the Matter of Cumberland Pharmaceuticals Inc.*, Exchange Act Rel. No. 98553 (Sept. 27, 2023).
3. *See* Litigation Rel. No. 2014-190, *SEC Announces Charges Against Corporate Insiders for Violating Laws Requiring Prompt Reporting of Transactions and Holdings* (Sept. 10, 2014), *available at https://www.sec.gov/news/press-release/2014-190*. In the 2014 initiative, the SEC announced settled charges against 28 officers, directors or major shareholders.
4. *See In the Matter of Nicole M. Fernandez-McGovern*, Exchange Act Rel. No. 98546 (Sept. 27, 2023).
5. *In the Matter of AgEagle Aerial Systems Inc.*, Exchange Act Rel. No. 98552 (Sept. 27, 2023) (Issuer's "officers and directors in the aggregate filed more than 125 untimely Forms 4").
6. Item 405(b)(3) of Regulation S-K provides that, in determining whether disclosure is required pursuant to Item 405(a), a registrant may rely on "any written representation from the reporting person that no Form 5 is required. The registrant must maintain the representation in its records for two years, making a copy available to the Commission or its staff upon request." Exchange Act Rule 16a-3(f)(1)(iii) requires all "holdings and transactions that should have been reported during the most recent fiscal year, but were not" to be reported on a Form 5 filing.
7. *See In the Matter of eXp World Holdings, Inc.*, Exchange Act Rel. No. 98551 (Sept. 27, 2023).
8. In a separate settled order, the SEC noted that the issuer made disclosures in its annual proxy statements regarding the untimely Form 4 filings by its insiders, which the issuer attributed to "administrative errors and due to the fact that the Company's headquarters in

Israel work Sundays through Thursday." While the SEC did not charge the issuer with violations of Item 405 of Regulation S-K, it charged the issuer with "causing" its insider's violations of Section 16(a) and Rule 16a-3, based on its insufficient procedures and practices. *See In the Matter of SolarEdge Technologies, Inc.*, Exchange Act Rel. No. 98549 (Sept. 27, 2023) (between January 2018 and October 2022, issuer's officers and directors in the aggregate filed untimely Forms 4 for reportable transactions that occurred on more than 60 dates). The SEC separately charged a director of this issuer, whom it alleged had untimely filed Forms 4 or Forms 4 amendments on 18 separate occasions between February 2018 and February 2021, including open-market sales totaling approximately $26 million in market value, with approximately half of these transactions reported one or more days late, with several being reported multiple months late, and at least one reported more than four years late. *See In the Matter of Avery More*, Exchange Act Rel. No. 98543 (Sept. 27, 2023).

9. *See In the Matter of Peixin Xu*, Exchange Act Rel. No. 98550 (Sept. 27, 2023).
10. The respondent was alleged to have failed to timely file four Schedule 13D amendments upon acquisitions of more than 1% during mid-2019 to early 2020, five Schedule 13D amendments upon dispositions of more than 1% during late 2020 (an amendment ultimately filed four months after the initial 1% disposition reflected a decrease in beneficial ownership from approximately 62.7 percent to approximately 24.8 percent), and four Schedule 13D amendments upon dispositions of more than 1 percent during early 2021 (an amendment ultimately filed about five months after the initial 1 percent disposition reflected an ownership decline from approximately 24.75 percent to 12.95 percent).
11. *See* Litigation Rel. No. 2023-201 (Sept. 27, 2023).

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