



SEC Enforcement Action on Recordkeeping and Reporting Violations

October 13, 2014

SEC Chair Mary Jo White's speech in October of 2013¹ should have served as a stern warning to all companies and individuals with SEC reporting requirements that the Commission would be broadly expanding its reach with the intent of punishing even the smallest of violations moving forward. Charges filed by the SEC last month² are proof that both individuals and companies are at risk if they do not ensure their compliance with all securities laws. This article focuses on the specific SEC reporting requirements and how Fortis may help you ensure compliance and avoid personal liability.

Section 16(a) Filings

Section 16(a) filings apply to officers, directors and any shareholder of greater than 10% of outstanding equity. Inadvertent mistakes or missed deadlines for required disclosure reports can result in charges, regardless of whether profits were made. In the September 2014 charges referenced above, some executives reported filing timely transaction documentation to their employer, but the employer did not file on the executives' behalf in a timely fashion. These executives were still held liable and paid significant fines³, up to \$100,000, as it is their responsibility to ensure that all regulations are complied with in an accurate and timely manner. The companies that were negligent in making the filings were also assessed significant fines.

Section 13(d) and 13(g) Filings

Section 13(d) and 13(g) filings apply to any beneficial owner of more than 5% of the outstanding equity of a public company. Any violation of these requirements may also be punished regardless of whether or not there was any intent to do so. Again, fines reached \$100,000 for individual violators. Therefore, meticulous care must be taken to ensure that all of the requirements are satisfied accurately and within the given time constraints or both the owner and the company can face SEC action. While some of these violators may have been overlooked in the past, it is now much more likely to be aggressively pursued given the new enforcement regime that is being instituted.

¹ <http://www.sec.gov/News/Speech/Detail/Speech/1370539872100#.VDQb-2d0y70>

² <http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370542904678#.VDQismd0y70>

³ <http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370542904678#.VDanLGd0y71>

Responsibility for Accuracy of Books and Records

Accountants and CFOs are not the only people that may be held liable for failing to maintain accurate books and records. “Control persons” may also be charged. A control/controlling person is one that, directly or indirectly, controls any person liable under other sections of the relevant securities laws. Directors and officers would certainly fit this description and can be held jointly and severally liable with the perpetrator.

To hold a control person liable, the plaintiff must allege culpable participation in the fraud by the controlling person. Culpable participation requires that the defendant knew or should have known that the person he or she was controlling was engaging in fraudulent conduct. Courts have held that allegations that board members were deeply involved in the day-to-day management of company and had “unfettered access” were insufficient where there were no allegations supporting a “strong inference” that the board members were actually aware of the red flags in question. Courts have not found a controlling person to be liable for a violation if he or she acted in good faith and did not directly or indirectly induce the act that caused the violation.

However, a controlling person can be held liable if he or she acts recklessly in failing to prevent a violation. Recklessness has been defined as highly unreasonable conduct which is an extreme departure from the standards of ordinary care. Fortis recommends that all directors and officers take steps to ensure that they are well-informed and that all proceedings and efforts to certify accuracy are well documented in order to limit their exposure to charges as a control person.

Falsified Records and Misleading Statements

Individuals, including directors and officers, may be held liable for aiding and abetting violations of securities laws if they have knowledge of the violation and substantially assist in the violation. With respect to accounting practices, for example, courts have held individuals liable based on only a general awareness that the accounting practices used were improper and did not require proof that the defendant had precise knowledge of accounting practices to fulfill the knowledge requirement.

Directors and officers may also be held individually liable under the requirements not to directly or indirectly falsify any books or records and not to mislead accountants or auditors. Courts are currently split on whether or not an individual must have knowledge of any violations of these rules. In Colorado, one must have knowledge of the violations but some jurisdictions may hold the individual liable for not proactively ensuring compliance. In either case, Fortis recommends that officers and directors make sure that detailed records are being produced and maintained to back up all decisions.

Fortis Law Partners

Fortis Law has broad expertise in handling SEC issues for public companies and their directors and officers. It has never been more important than now to ensure that both you and your company are in 100% compliance with all applicable securities laws. The proactive

investment of time and resources to set up the appropriate systems and procedures will pay dividends for years to come.

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