

CLIENT MEMORANDUM

SEC Issues Cease-and-Desist Orders for Failure to Amend Item 4 of Schedule 13D

April 22, 2015

AUTHORS

Steven J. Gartner | **William H. Gump**

In March 2015, the Securities and Exchange Commission (the “SEC”) initiated eight cease-and-desist proceedings against investors and public company insiders for failing to timely amend their Schedule 13D filings pursuant to the Securities Exchange Act of 1934, as amended (the “Exchange Act”). Specifically, the SEC initiated these proceedings for the investors’ and insiders’ failure to amend Item 4 of their Schedule 13D after they took certain preliminary steps to take a public company private. These proceedings indicate that the SEC has increased its focus on the failure of investors and insiders to amend Item 4 of Schedule 13D once certain steps are taken to move forward with a transaction, but before a plan or proposal is fully formulated.

Under Section 13(d)(1) and Rule 13d-1(a) of the Exchange Act, any person or group who has acquired, directly or indirectly, beneficial ownership of more than five percent of a class of a registered equity security is required to file a Schedule 13D with the SEC making certain disclosures, including the identity of the owners and the purpose of the acquisition. The purpose or purposes of the acquisition of the securities must be disclosed by the beneficial owner under Item 4 of Schedule 13D, which provides a list of plans or proposals a beneficial owner may have that would trigger an Item 4 reporting obligation, including additional purchases of securities, a merger, a reorganization, a liquidation and a going-private transaction. Pursuant to Section 13(d)(2) and Rule 13d-2(a) of the Exchange Act, a beneficial owner is required to promptly amend its Schedule 13D when there are material changes or developments in the information previously reported.

SEC Issues Cease-and-Desist Orders for Failure to Amend Item 4 of Schedule 13D

Continued

Many investors include broad language in Item 4 of Schedule 13D and then rely on it to delay amendments when they are engaged in discussions relating to a going-private transaction or similar matters. Historically, to determine whether an amendment was necessary, practitioners focused on whether a plan or proposal for the transaction had been formulated. Engaging in discussions relating to a transaction did not necessarily trigger an amendment.

The SEC seems to have rejected this approach with the proceedings initiated in March 2015. In a March 13, 2015 SEC press release, issued concurrently with the initiation of the eight cease-and-desist proceedings, the SEC Director of the Division of Enforcement stated, “Stale, generic disclosures that simply reserve the right to engage in certain corporate transactions do not suffice when there are material changes to those plans, including actions to take a company private.”¹ According to the new proceedings, depending on the specific facts and circumstances, an amendment to Item 4 of Schedule 13D may also be required “before a plan has been formulated because the obligation to revise arises...promptly after a ‘material change occurs in the facts set forth’ in the Schedule 13D.”² Specifically, the SEC noted the following as evidence of a need to amend Item 4:

- informing a company to be taken private of the beneficial owner’s intent to do so;
- assisting a company to be taken private in going private by securing waivers from shareholders to remove registration requirements on preferred stock;
- discussing strategies for going private with a company to be taken private;
- requesting management of a company to be taken private to engage outside counsel for the contemplated transaction; and
- discussing the engagement of an independent financial advisor to give a fairness opinion regarding the contemplated transaction.³

¹ SEC, Press Release, *Corporate Insiders Charged for Failing to Update Disclosures Involving “Going Private” Transactions* (Mar. 13, 2015), available [here](#).

² See *In the Matter of Berjaya Lottery Management (H.K.) Ltd.*, SEC Order Instituting Cease-and-Desist Proceedings (Mar. 13, 2015), available [here](#).

³ See *In the Matter of Berjaya Lottery Management (H.K.) Ltd.*, SEC Order Instituting Cease-and-Desist Proceedings (Mar. 13, 2015); *In the Matter of The Ciabattoni Living Trust Dated August 17, 2000*, SEC Order Instituting Cease-and-Desist Proceedings (Mar. 13, 2015); *In the Matter of Anthony J. Ciabattoni*, SEC Order Instituting Cease-and-Desist Proceedings (Mar. 13, 2015); *In the Matter of Jane G. Ciabattoni*, SEC Order Instituting Cease-and-Desist Proceedings (Mar. 13, 2015); *In the Matter of SMP Investments I, LLC*, SEC Order Instituting Cease-and-Desist Proceedings (Mar. 13, 2015); *In the Matter of Brian Potiker*, SEC Order Instituting Cease-and-Desist Proceedings (Mar. 13, 2015); *In the Matter of William A. Houlihan*, SEC Order Instituting Cease-and-Desist Proceedings (Mar. 13, 2015); *In the Matter of Shuipan Lin*, SEC Order Instituting Cease-and-Desist Proceedings (Mar. 13, 2015). All SEC orders instituting cease-and-desist proceedings are available [here](#).

.....

SEC Issues Cease-and-Desist Orders for Failure to Amend Item 4 of Schedule 13D

Continued

Investors are cautioned to be vigilant about the need to amend Item 4 of Schedule 13D. It is important to note that while the fines in these eight proceedings were not material, the cases dealt with relatively small transactions. Moreover, the reputational risk associated with a consent decree is far more significant to most investors than any possible fine.

If you have any questions regarding this memorandum, please contact Steven J. Gartner (212 728 8222, sgartner@willkie.com), William H. Gump (212 728 8285, wgump@willkie.com) or the Willkie attorney with whom you regularly work.

Willkie Farr & Gallagher LLP is an international law firm with offices in New York, Washington, Houston, Paris, London, Frankfurt, Brussels, Milan and Rome. The firm is headquartered at 787 Seventh Avenue, New York, NY 10019-6099. Our telephone number is (212) 728-8000 and our fax number is (212) 728-8111. Our website is located at www.willkie.com.

April 22, 2015

Copyright © 2015 Willkie Farr & Gallagher LLP.

This memorandum is provided by Willkie Farr & Gallagher LLP and its affiliates for educational and informational purposes only and is not intended and should not be construed as legal advice. This memorandum may be considered advertising under applicable state laws.