

Overview of the Reporting Obligations that Apply to Public Companies and Their Directors

February 11, 2015

Megan Gates
(617) 348-4443
Mgates@mintz.com

Daniel Kajunski
(617) 348-1715
Dtkajunski@mintz.com

Outline of Presentation

- General concepts relating to the Securities Exchange Act of 1934 (the '34 Act)
- Review of the various forms required under the '34 Act

The '34 Act

- Federal rules that regulate the markets for trading in securities already issued and outstanding (the secondary market)
- Objective is to provide investors with material information and to prevent fraud and misrepresentation in the trading, voting and tendering of securities
- Primarily disclosure focused, but Sarbanes Oxley Act of 2002 (SOX) and Dodd-Frank Act of 2010 emphasize compliance and add governance

Reporting

- Under the '34 Act, public companies must file periodic, current and other reports (e.g., 10-Ks, 10-Qs, 8-Ks and proxy statements) with the SEC
- Filed after the end of fiscal reporting periods and in connection with, or after the occurrence of, certain types of events
- Available to the public through the SEC's web site and through each public company's web site

The Securities Act of 1933 (the '33 Act)

- Federal rules that regulate the offer and sale of securities
- Primary means by which '33 Act accomplishes its goal – registration
- Requires a company to make full disclosure of all material facts before offering securities for sale
- Prohibits fraudulent or deceptive practices in any offer or sale of securities

Types of Issuers and Public Float

- The size of an issuer's public float determines timing of 10-Ks, 10-Qs and eligibility for reduced "smaller reporting company" disclosures
- Public float is market capitalization excluding shares held by affiliates (control persons – executive officers, directors and greater than 10% stockholders)
- Usually determined as of last business day of prior year's 2nd fiscal quarter
 - Large Accelerated Filer = \$700m or more and public at least 1 year
 - Accelerated Filer = \$75m or more and public at least 1 year
 - Smaller Reporting Company = Below \$75m (or below \$50m revenues if

Emerging Growth Company (EGC)

- An issuer that had total annual gross revenues of less than \$1 billion (will be indexed in the future) during its most recently completed fiscal year
- Remains an emerging growth company until the earlier of:
 - The last day of the fiscal year in which it had total gross revenue greater than \$1 billion
 - The last day of the fiscal year of the issuer's 5th anniversary of the date of its first registered sale of common equity securities
 - The day on which the issuer has, during the previous 3-year period, issued more than \$1 billion in non-convertible debt
 - The date on which the issuer is deemed to be a "large accelerated filer"
- Jumpstart Our Business Startups (JOBS) Act signed into law April 5, 2012.

Form 10-K (Annual Report)

- Filed after the end of each fiscal year
- Due:
 - non-accelerated filer, 90 days after the end of the fiscal year
 - accelerated filer, 75 days after the end of the fiscal year
 - large accelerated filer, 60 days after the end of the fiscal year
- Provides comprehensive information about the company's business, management and financial status during the year
- Similar to the information disclosed in a registration statement under the '33 Act

The Information Contained in the Form 10-K Includes

- Description of the company's business for the past 5 years (2 for smaller reporting companies),
- Risk factors (not required for smaller reporting companies),
- Audited financial statements,
- MD&A (off balance sheet arrangements and tabular description of contractual obligations not required for smaller reporting companies),
- Auditor's report on the effectiveness of the issuer's "internal controls over financial reporting" under SOX Section 404 (not required for smaller reporting companies and EGC),
- Information about the company's directors and executive officers,
- Description of executive compensation (CD&A not required for smaller reporting companies and EGC), and
- Certain corporate governance issues

The Two Most Important Sections of the 10-K

- Financial statements
- Management's discussion and analysis of the company's financial condition and results of operations (MD&A)

10-K Financial Statements

- Audited
- Prepared in accordance with Regulation S-X as well as U.S. generally accepted accounting principles (GAAP)

10-K Financial Statements Include

- Auditor's opinion
- Balance sheets as of the end of the most recent fiscal year and the previous fiscal year
- Statements of income, cash flows and stockholders' equity for the most recent fiscal year and the previous two fiscal years
- Notes to the financial statements

Smaller Reporting Companies and Emerging Growth Companies :

- Need only include statements of income, cash flows and stockholders' equity for the most recent fiscal year and the previous fiscal year

EGC only:

- Selected financial data is not required for any period prior to the earliest audited period presented in connection with IPO
- First 10-K must comply with S-X 3-02 or 8-02

10-K MD&A

- Purpose is to provide investors with a narrative explanation of the company's financial statements that enables investors to see the company's financial condition and results of operations through the eyes of management
- Includes any material changes in its results of operations
 - in the most recent fiscal year compared to the previous fiscal year, and
 - in the previous fiscal year compared to the fiscal year before that
- Also discusses the company's liquidity and capital resources and any material changes in its financial condition that occurred during the fiscal year
- Required to address known material trends and uncertainties that would cause the reported financial information not to be necessarily indicative of future operating performance or financial condition

Liability

- There are a number of statutory provisions that provide for liability of various parties under the '34 Act
- Rule 10b-5 under §10(b) of the '34 Act is by far the most important civil liability provision of the securities laws

Rule 10b-5

- Prohibits fraud and deceit (including material misstatements or omissions) in connection with any purchase or sale of a security
- Defendant must have acted knowingly or recklessly (negligent mistakes okay under 10b-5, but are actionable under certain other liability provisions - Section 17(a) of the '33 Act)
- Plaintiff must show reliance and loss causation

Rule 10b-5 can be Enforced

- By the SEC in civil or administrative enforcement actions seeking injunctive relief, statutory bars, disgorgement and/or civil penalties
- By the Justice Department in actions seeking criminal penalties for willful violations of the '34 Act
- By buyers and sellers of securities in private actions

Statute of Limitations and Remedies for a Private Right of Action

- 2 years after discovery of facts constituting the violation and not later than 5 years after the violation
- Includes injunctive relief as well as damages equal to the difference between the price paid or received and the true value at the time of purchase or sale
- Where the plaintiff dealt face-to-face with the defendant and the securities purchased or sold have not been re-transferred, the plaintiff may at his option sue for rescission rather than damages

Materiality

- 10b-5 claims are often predicated on material misstatements or omissions
- A fact concerning a company is "material" if, in the Supreme Court's words, "there is a substantial likelihood that a reasonable investor would consider the fact important in deciding whether to buy, sell or hold the [company's] stock"
- A fact is considered important to an investor's decision if "there is a substantial likelihood that disclosure of the omitted fact would be viewed by the reasonable investor as having significantly altered the 'total mix' of information made available"
- Analysis is both quantitative (e.g., under 5% of net income) and qualitative (e.g., masks a change of earnings, market expected to react negatively)
- Nevertheless, an abstract concept that will often be revisited with the benefit of hindsight

Form 10-Q (Quarterly Report)

- Due 45 days after fiscal quarter end (unless an accelerated filer or large accelerated filer, in which case it is 40 days)
- Provides unaudited financial information about the company for the completed quarter, including quarterly financial statements and MD&A
- Includes a description of any material events that occurred during the quarter, including an update of risk factors, litigation and events that would trigger the filing of a Form 8-K

Form 8-K (Current Report)

- A public company must file a Form 8-K to report certain material events, including
 - entering into or terminating a material agreement
 - changes in the executive officers and directors of the company
 - acquisitions or dispositions of businesses or assets
 - changes in the company's auditors
 - the issuance of earnings releases
 - any difficulties with trading the company's securities
 - bankruptcy
- Generally, must be filed within 4 business days after the triggering event

Form 12b-25 (Notice of Inability to Timely File)

- Must be filed no later than 1 business day after the due date of the annual or quarterly report to which it relates
- Extends due date for annual report for 15 days and quarterly report for 5 days
- Note that it may not be used to extend the time period for an 8-K
- Allows a public company to avoid the penalties for not timely filing its reports – for example, eligibility to use a short-form registration statement

Proxy Solicitation Rules

- Public companies generally must also comply with the proxy solicitation rules
- Regulate communications in which a company solicits proxies from its stockholders so that the stockholders can exercise their right to vote without having to physically attend the stockholders meeting

The Proxy Statement (Schedule 14A)

- Sent by the company to its stockholders
- Solicits proxies from each stockholder for the meeting
- Provides information about the stockholders meeting, including
 - the date, time, and place of the meeting,
 - the matters to be voted on,
 - the stockholder vote required to approve each matter, and
 - the company's recommendations on each matter

The Proxy Statement

- Also provides certain information about the company, including
 - corporate governance matters:
 - ❖ description of the board of directors and each committee of the board
 - ❖ the company's corporate governance policies, and
 - ❖ reports from each of the audit and compensation committees
 - executive and director compensation, and
 - ownership of the company's securities by directors, executive officers and large stockholders

Proxy Statement Timing

- The company must file the proxy statement with the SEC no later than the day that it begins to deliver its proxy materials to its stockholders
- A company's organizational documents and state corporate law set time periods for delivery of a notice of the meeting (which is included in the proxy statement)
- Typically, at least 10 days, but no more than 60 days, before the meeting date
- In practice, companies distribute their proxy materials as far ahead of the meeting date as possible
- The board of directors reviews and approves the proxy materials before they are filed or distributed

Annual Report to Shareholders

- SEC rules require companies to send an “annual report” to shareholders with the proxy statement
- The annual report contains much of the same information as the Form 10-K, but is
 - direct communication to the stockholders
 - subject to much less regulation and supervision by the SEC
 - often presented in a more attractive format (on glossy paper, and containing pictures and charts of information)
- The proxy solicitation rules require a company to provide copies of its annual report to the SEC when it delivers its proxy materials to its stockholders

Section 16 Short Swing Profit Rule

- Rule that requires company insiders to return to the company any profits made from the purchase and sale of company stock if both transactions occur within a 6-month period
- A company insider is any executive officer, director or holder of more than 10% of the company's equity shares
- The rule was implemented to prevent insiders, who have greater access to material company information, from taking advantage of information for the purpose of making short-term profits
- No requirement that the insider had special knowledge; good faith or inadvertence is not a defense

Section 16 Reports

- Short swing profit rule enforced through the filing of forms (Forms 3, 4 and 5)
- The '34 Act requires insiders to report the equity securities of a public company in which they have a voting or investment interest
 - including derivatives such as stock options, warrants, rights and other convertible securities
- Although these forms are the responsibility of each individual filer, in practice, they are filed by the company on behalf of company directors and executive officers
- Late reports disclosed in the proxy statement

Form 3

- Initial report of beneficial ownership is filed after either
 - the company becomes public, or
 - a person becomes an executive officer or director or holder of more than 10% of a public company's equity shares
- A Form 3 must be filed 10 days after the triggering event occurs even if the filer does not beneficially own any company stock at that time

Form 4

- Reports any changes in the filer's beneficial ownership of the company's equity securities, including:
 - purchases or sales of stock
 - receipt of grants of stock options or restricted stock
 - exercise of stock options, warrants or other securities convertible into equity
- A Form 4 must be filed 2 business days after the triggering event occurs

Form 5

- Annual report filed after the end of the company's fiscal year
- Reports all transactions that occurred during the previous fiscal year that either were not required to be reported on a Form 4 (e.g., gifts or “small acquisitions” - \$10,000 over any 6 month period) or should have been reported on a Form 3 or Form 4 but were not (a delinquent filing)
- Does not need to be filed if the filer had no transactions to report

Significant Stockholder Reporting

- The '34 Act requires stockholders owning more than 5% of any class of a public company's equity securities to file reports
- Purpose is to alert investors to potential changes in control and to provide them with an opportunity to evaluate the effects of these potential changes
- Reported on either Schedule 13D or Schedule 13G
- These forms are the responsibility of each individual stockholder and are generally prepared and filed by the stockholder's counsel

Schedule 13G – Eligible Filers

- Exempt stockholders that beneficially owned 5% or more of a company's stock before the public company was public and registered under the '34 Act
- Passive investors that:
 - own less than 20% of a company (but more than 5%)
 - did not acquire their shares for the purpose, or with the effect, of changing or influencing control of the company
- Schedule 13G must be filed after the end of the calendar year in which the '34 Act registration occurred and amended annually, after the end of each calendar year, to report any changes in ownership, unless, in the case of a passive stockholder, its ownership exceeds 10%, in which case the amendment is due promptly
- Such a stockholder must also promptly amend its Schedule 13G to report any increase or decrease of more than 5% in its beneficial ownership of the company's stock

Schedule 13G – Information Required

- Requires less disclosure about the stockholder than the Schedule 13D. The primary information disclosed consists of:
 - who the stockholder is
 - how many shares of the company the stockholder owns and how the shares are owned
 - a certification that the stockholder is a passive investor (if applicable)

Schedule 13D – Information Required

- Longer, more extensive form than Schedule 13G
- Additional required disclosure includes:
 - the source of the funds used to buy the shares
 - the stockholder's purpose for owning the shares

Schedule 13D Filing Dates

- Initial Schedule 13D is due 10 days after the 5% threshold is crossed
- A stockholder must amend its Schedule 13D promptly to report:
 - any material change to the information in the Schedule
 - any increase or decrease of 1% or more in its beneficial ownership of the company's stock

THANK YOU

Megan Gates
(617) 348-4443
Mgates@mintz.com

Daniel Kajunski
(617) 348-1715
Dtkajunski@mintz.com

One Financial Center, Boston, MA 02111