

## SEC announces new “sweep” of enforcement actions aimed at failures to make timely Section 16 reports

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The SEC charged six public company insiders for failing to timely file reports under Section 16 of the Exchange Act and five public companies for contributing to the filing failures by insiders and/or failing to disclose their insiders' filing delinquencies in their proxy statement. These actions are the latest in an ongoing enforcement initiative by the SEC that began in 2014 and demonstrate the SEC's commitment to enforcing Section 16 reporting requirements.

### Background

On September 27, 2023, the SEC [announced](#) a new “sweep” of enforcement actions against six insiders for failing to timely file multiple reports under Section 16 of the Securities Exchange Act of 1934 (Exchange Act) (and, for three of the insiders, also under Section 13 of the Exchange Act), and against five companies for negligence in contributing to their insiders' reporting failures and/or for failing to properly disclose such reporting delinquencies in their annual proxy statement under Item 405 of Regulation S-K. The penalties associated with these actions against the insiders ranged from \$120,000 to \$150,000 and against the companies ranged from \$115,000 to \$200,000.

This sweep of actions is part of an ongoing enforcement initiative by the SEC that commenced in 2014 and demonstrates the SEC's continued focus on enforcing Section 16 reporting requirements, particularly against repeated delinquent filers.

In the background to this latest enforcement sweep is the recent expansion of Section 13 and 16 reporting obligations, including the adoption of final rules in December 2022 to require [gift transactions](#) to be reported on a Form 4 within two business days and in October 2023 to [shorten filing deadlines under Section 13](#) of the Exchange Act.

### Overview of reporting requirements

Section 16(a) of the Exchange Act requires “insiders” — i.e., officers and directors of a public company, as well as beneficial owners of more than 10% of the company's registered equity securities — to file statements of their beneficial ownership of the company's equity securities with the SEC, including any changes to their beneficial ownership.

Under Section 16(a), insiders must generally report their initial holdings on Form 3 within 10 calendar days of when the person becomes an insider. In addition, insiders must report most equity transactions (including purchases and sales, gifts and compensation-related transactions (e.g., equity compensation grants, sales to cover exercise price payments and tax withholding obligations)) on Form 4 within two business days of the transaction. They must also report certain previously unreported transactions on Form 5 within 45 days after the end of the applicable fiscal year.

In addition, under Item 405 of Regulation S-K, a public company is required to disclose in its proxy statement any delinquent Section 16 filing (including the number of late reports and transactions) or any known failure by an insider to file a Section 16 report.

# Analysis of enforcement actions

## Insiders

The six insiders who were charged included officers, directors and more than 10% beneficial owners of public companies. These insiders were repeated delinquent filers, having from 20 to 73 delinquent filings between 2018 and 2022. The delinquent transactions involved open market and private purchases and sales (including pursuant to 10b5-1 trading plans), equity award grants, stock option exercises and other derivatives transactions that were delinquent by periods ranging from less than one week to four years and four months.

For example, the order against [Nicole M. Fernandez-McGovern](#), an officer of AgEagle Aerial Systems (AgEagle), noted that the insider filed Forms 4 on an untimely basis for nearly all her reportable transactions between June 2018 and March 2022, in some cases delayed over a year. Similarly, the order against [Joseph Theodore Lukens, Jr.](#), noted that the insider failed to file Forms 4 on a timely basis for nearly all his reportable transactions from July 2019 to July 2020.

In addition, three of the insiders (all of whom were major shareholders in public companies) failed repeatedly over a time period ranging from two to four years to timely file amendments to their Schedule 13D/G.

## Companies

All five companies charged by the SEC were found to have caused the Section 16(a) violations by their insiders. The orders emphasize that these companies voluntarily agreed to assist their insiders by performing certain tasks in connection with the filing of Section 16 reports on their behalf. However, in all five cases, the companies were found to have acted negligently in their performance of such tasks and caused their insiders to fail to file Section 16 reports on a timely basis, despite being notified and/or having such necessary information to complete the filings in a timely manner. The number of delinquent filings for which the SEC said the companies were responsible ranged from 60 to 150, which all related to failures to timely file Forms 4.

For example, as detailed in the order against [AgEagle Aerial Systems Inc.](#), AgEagle voluntarily agreed to assist its insiders with the filing of their Section 16(a) reports. However, between March 2018 and June 2022, AgEagle's insiders filed more than 125 Forms 4 on an untimely basis.

In addition, three of the companies were charged with failing to comply with Item 405 disclosure requirements in their annual proxy statements, and one company (which did include the Item 405 disclosure) was found to have material deficiencies in its disclosure (i.e., by failing to specify the number of late filings and transactions). The SEC emphasized that a company may only omit the Item 405 disclosure if there are no Section 16(a) delinquencies to report, and in all these cases, multiple insiders filed numerous untimely Section 16(a) reports, which should have been disclosed.

For example, the order against [Cumberland Pharmaceuticals Inc.](#) noted that the company failed from its fiscal year 2019 to fiscal year 2021 to provide this disclosure, despite more than 150 untimely Forms 4 between May 2019 and April 2022. Similarly, the order against [Lattice Semiconductor Corporation](#) noted that the company failed for four consecutive years from fiscal year 2018 to fiscal year 2021 to provide this disclosure, despite more than 75 untimely Forms 4 between May 2018 and February 2022.

## Recent history of Section 16 enforcement action

This latest set of enforcement actions is not the first time the SEC had brought charges against multiple insiders and companies under Section 16, but is instead part of an ongoing enforcement initiative over the past decade:

- [In 2014, the SEC brought similar charges against 34 insiders and companies](#) based on similar violations of Section 16 (and Section 13) reporting requirements. Specifically, the SEC brought charges against 13 officers and directors alleging violations of Section 16(a), five individual investors and 10 investment funds or their investment advisers. Over half of the insiders charged in the 2014 sweep relied on their companies to file their reports timely. Additionally, five of the companies charged were also charged with failing to comply with Item 405 disclosure requirements. The respondents in the 2014 sweep collectively paid penalties totaling \$2.6 million.
- Soon afterward, [in 2015, the SEC brought charges against eight insiders](#) who were Schedule 13D filers who failed to timely amend their Item 4 disclosures to report “significant steps” they had taken toward a going-private transaction.

Five of those actions also involved violations of Section 16 reporting requirements. The respondents in these 2015 enforcement actions paid penalties that ranged from \$15,000 to \$75,000.

- Most recently in 2020, the SEC again filed charges against two insiders (available [here](#) and [here](#)) for Section 16 reporting violations. One of the insiders charged in 2020 was ordered to pay \$50,000 while the other was ordered to pay \$150,000 in penalties.

## Key takeaways

This sweep of actions underscores the SEC's ongoing commitment to enforcing Section 16 reporting requirements by both insiders and companies alike. While these actions appear to have been targeted at serial offenders with multiple late filings or reporting deficiencies, it is clear that the SEC will continue to scrutinize insiders and companies who do not comply with their Section 16 reporting obligations. In addition, similar to prior Section 16 enforcement sweeps, the SEC enforcement staff indicated that it used "data analytics to identify the charged insiders as repeatedly filing these reports late".

Accordingly, companies, especially those that have agreed to assist their insiders with their Section 16 filings, should closely monitor reporting compliance and consider adopting more comprehensive protocols to ensure compliance going forward. Some steps companies could consider include:

- **Educating first-time insiders about their obligations and restrictions imposed on them by Section 16.** First-time insiders may be unaware of these rules, and accordingly, any onboarding process can serve as a fruitful time to explain these requirements.
- **Confirming that the companies' compliance teams are well supported and knowledgeable about Section 13 and 16 reporting requirements.** Companies that have recently completed an IPO (and for whom these reporting responsibilities may be new) should ensure that their compliance teams are aware of and prepared to assist insiders, if applicable, with these filings. In addition, companies should make sure that compliance teams are sufficiently staffed so that more than one individual has knowledge and is capable of handling Section 13 and 16 filings.
- **Reviewing and confirming information regarding brokers, financial advisors and estate planning advisors who may assist the insiders in any beneficial ownership transactions.** Companies should be mindful that not all brokers and financial advisors that an insider engages may be familiar with the Section 16 requirements. Establishing clear lines of communication with these parties, and ensuring that they are appropriately educated as to these requirements can help to avoid any untimely filings or missed holdings.
- **Reviewing and confirming insiders' beneficial ownership holdings.** D&O questionnaires should provide detailed requests and information to help assist insiders provide comprehensive and accurate responses regarding equity security ownership. In addition, companies and insiders should keep in mind that equity securities held in estate planning vehicles (e.g., trusts) may also be subject to Section 16 reports. Accordingly, insiders should be reminded to discuss with the company's legal or compliance team before proceeding with any estate planning transactions involving company equity securities.
- **Ensuring sufficient flexibility with powers of attorney.** Companies who have insiders execute a power of attorney to permit the company to file Section 16 reports on the insider's behalf should have multiple employees of the company listed as being delegated authority to file Section 16 reports on the insider's behalf (for example, in case one individual is out sick or on vacation).
- **Tracking insiders' Section 16(a) triggering events.** Establishing a calendar of scheduled Section 16 reporting events of which the company is aware — for example, future grant dates or vesting/settlement dates of equity incentive awards.
- **Closely tracking delinquent filings.** Companies should take care to keep a running list of all delinquent filings each year in order to ensure compliance with Item 405 disclosure requirements and to properly disclose in the annual proxy statement the information required by Item 405 regarding delinquent filings.

If you have any questions regarding the matters covered in this publication, please reach out to any of the lawyers listed below or your usual Davis Polk contact.

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