

## Is everything an accounting control violation now?

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After receiving board approval to buy back stock under a 10b5-1 plan, a company interpreted Rule 10b5-1 in a manner with which the SEC disagreed. The SEC did not allege that the company traded on the basis of material nonpublic information, but brought a \$25 million enforcement proceeding stating that the company's incorrect interpretation of Rule 10b5-1 meant it lacked adequate accounting controls.

On November 14, 2023, the SEC announced a settled administrative [proceeding](#) against Charter Communications relating to the company's stock buybacks. The company's board authorized the buybacks and predicated the authorization on the company's use of trading plans that comply with the affirmative defense provided by Rule 10b5-1 under the Securities Exchange Act of 1934. That rule provides an affirmative defense to an allegation of insider trading if, among other things: (1) the trades are made pursuant to a written plan, (2) the plan is entered into when the trader did not have material nonpublic information, and (3) the plan does not permit the trader to exercise subsequent influence over how, when, or whether to effect the transactions.

The SEC concluded that the company used trading plans that did not qualify for the Rule 10b5-1 affirmative defense. The plans contained an "accordion" provision that would increase the amount of share repurchases if the company conducted debt offerings that included buybacks as a permitted use of proceeds. Because the company had discretion over whether and when to do the debt offerings, the SEC concluded that the company did not meet the conditions of Rule 10b5-1 and thus did not act within the board's authorization.

Although the SEC concluded that the company did not satisfy the Rule 10b5-1 affirmative defense, the SEC did *not* allege that the buybacks constituted insider trading or any other type of fraud. Instead, the SEC concluded that the company's failure to conduct its share buybacks in accordance with the board's instruction to use Rule 10b5-1 plans was the result of a lack of *internal accounting controls*, in violation of Exchange Act Section 13(b)(2)(B). This provision, originally enacted as part of the Foreign Corrupt Practices Act of 1977, requires public companies to "devise and maintain a set of internal accounting controls" that, among other things, provide reasonable assurances that "access to assets is permitted only in accordance with management's general or specific authorization." Notably, there is no scienter requirement to an internal controls charge, and the SEC has applied what amounts to a strict liability standard.

According to the SEC, Charter violated this requirement because it "did not have reasonably designed controls to analyze whether the discretionary element of the accordion provisions was consistent with the Board's authorizations." The SEC made this finding notwithstanding the fact that the SEC recited several controls that Charter had in place, including: (1) ensuring that management obtained board authorization for buybacks; (2) staying within the board's financial parameters and guidelines; and (3) confirming buybacks were accurately reflected in the company's accounts and ledgers.

Charter agreed to settle the case, without admitting or denying the allegations, and pay a \$25 million penalty. The order did not require an independent compliance consultant to review the company's controls.

SEC commissioners Hester Peirce and Mark Uyeda dissented from the settled proceeding because they believe that the internal accounting controls provisions do not apply to these facts. They warned that the SEC was improperly using Section 13(b)(2)(B) to compel companies to adopt policies and procedures that the SEC believes are good corporate

practice but are not required by law. They said that in this matter the SEC was not distinguishing between accounting controls and other types of controls: “Controls designed to answer a legal question—compliance with the regulatory conditions necessary to qualify for an affirmative defense—are simply not internal accounting controls within Section 13(b)(2)(B)’s scope.”

## Takeaways

The Charter proceeding follows a similar 2020 SEC settlement with Andeavor LLC that used Section 13(b)(2)(B) to charge an accounting controls violation in connection with a corporate buyback. The issue in that case involved controls to ensure that the company did not possess material nonpublic information when it initiated the buyback plans. We [noted at the time](#) that the SEC was employing a novel theory that highlighted the need for policies and procedures around buybacks.

While the SEC’s expansive view of the internal accounting controls provisions to reach clearly non-accounting conduct has so far centered on stock buybacks, the SEC noted in a footnote in the Charter order that it had always interpreted the provisions to apply to “corporate accountability” more broadly. Companies should be aware that the future enforcement approach might not be limited to buybacks. Any scenario in which a company engages in transactions with corporate assets in a manner that does not fully comply with a particular board authorization could come under SEC scrutiny for potentially deficient internal accounting controls, especially if there is a linkage to conduct that a majority of SEC commissioners believes falls short of good corporate practice.

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