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Recent SEC Enforcement Actions Target Inadequate Disclosure in M&A Transactions and Shareholder Activist Campaigns

Since the beginning of 2017, the SEC has announced three enforcement actions charging companies, activist hedge funds and related individuals with violating the Securities Exchange Act of 1934 (Exchange Act). These enforcement actions targeted parties who allegedly failed to comply with disclosure obligations in the context of hostile takeovers and shareholder activism campaigns.

Allergan, Inc.

On January 17, 2017, the SEC announced an enforcement action against Allergan, Inc. (Allergan) for violations of Section 14(d) of the Exchange Act and Rule 14d-9 relating to its response to an unsolicited tender offer. By way of background, in June 2014 Valeant Pharmaceuticals International Inc. and its co-bidders launched an unsolicited tender offer to acquire Allergan. In response, Allergan filed a Schedule 14D-9, as required, and recommended against the tender offer. Allergan also stated that it was not engaged in any negotiations for a merger or other combination. Under Item 7 of Schedule 14D-9 (which incorporates Item 1006(d) of Regulation M-A), a registrant is required to disclose certain negotiations entered into in connection with a tender offer. Exchange Act Rule 14d-9 requires a registrant to report all material changes to the information set forth in Schedule 14D-9.

Subsequently, Allergan began communicating with two third parties regarding possible alternative transactions. First, Allergan entered into discussions to buy another company, referred to as "Company A." On July 29, 2014, Allergan proposed to acquire Company A and proposed a specific purchase price. After further communications between the parties, Allergan increased its bid price, and on August 25, 2014, Company A made a counterproposal. Ultimately, the negotiations fell through. Allergan did not amend its Schedule 14D-9 to disclose that it had entered into negotiations with Company A.

Second, Allergan entered into discussions with Actavis plc (Actavis), which emerged as a "white knight" and ultimately acquired Allergan. The discussions began on July 30, 2014, and evolved through November 2014 with various proposals and counterproposals. After Activis executed a confidentiality and standstill agreement on November 5, 2014, Allergan amended its Schedule 14D-9 to state that it had been approached by an unnamed third party and that discussions had continued that may lead to negotiations. The parties eventually signed a definitive merger agreement on November 16, 2014. When media sources reported that Allergan was in discussions with potential third parties, the SEC's Division of Corporate Finance notified the company's legal counsel that any negotiations that may be taking place must be disclosed under Item 7 of Schedule 14D-9. With the exception of the disclosure following the confidentiality and standstill agreement, however, Allergan did not disclose any of the negotiations leading up to the Actavis merger agreement.

According to the SEC, Allergan's amendment to its Schedule 14D-9 failed to disclose in a timely manner material changes to its prior disclosures, mischaracterized the communications between the parties as not having risen to the level of "negotiations," and did not disclose the fact that negotiations were already taking place. In its enforcement action, the SEC stated that with regard to Company A, Allergan was engaging in merger negotiations by the time Company A had made its counterproposal. It also stated that Allergan never disclosed it was in negotiations with a third party to enter into a transaction that would have made it more difficult for Valeant to acquire Allergan. Additionally, in the case of Actavis, the SEC said Allergan was in

negotiations when Allergan responded to a second proposal from Activis with guidance on what price would be acceptable. In each of these instances, the SEC claimed that the company was required to amend its Schedule 14D-9 to disclose the negotiations, as this was material information.

Although Allergan contended that disclosure was not required because the board had decided it would jeopardize negotiations and instructed management not to disclose the possible terms of a transaction until an agreement in principle had been reached, the SEC disagreed. While the Instruction to Item 1006(d) of Regulation M-A provides that target companies may withhold possible terms of the transaction if the subject company's board believes that such disclosure would jeopardize the continuance of negotiations, in such instance, negotiations are still required to be disclosed and the company may state that they are in the preliminary stages. Once the negotiations result in an agreement in principle, the SEC's position is that such an event is required to be disclosed as well. The SEC accepted an offer of settlement under which Allergan agreed to pay a $15 million penalty for failure to make adequate disclosures.

CVR Energy, Inc.

On February 14, 2017, the SEC announced an enforcement action against CVR Energy, Inc. (CVR) for violations of Exchange Act Section 14(d)(4) and Rule 14d-9 in connection with a tender offer launched by an activist investor. The tender offer was commended in February 2012. CVR filed a Schedule 14D-9, recommending that shareholders not tender their shares. The Schedule 14D-9 disclosed that CVR had retained two investment banks as financial advisors and agreed to pay "customary" compensation for their services. CVR's arrangement with the investment banks, however, also provided that they were entitled to success fees in the event of a sale of the company, even if the sale price was not deemed adequate by the board, the activist investor was successful in its bid, or the investment bank failed to obtain an increased price from the activist. Ultimately, the shareholders tendered their shares to the activist investor, and the investment banks were entitled to success fees totaling $36 million.

Item 5 of Schedule 14D-9 requires that a subject company must summarize the material terms of the compensation arrangements for advisors hired to assist with the tender offer response. The SEC stated that the terms of the banks' fee arrangements were material information that CVR did not disclose to shareholders in its Schedule 14D-9. The SEC said this failure to fully disclose the material terms of the compensation arrangement with the investment banks and notify shareholders of the banks' potential conflicts of interest was a violation of Exchange Act Section 14(d)(4) and Rule 14d-9. Due to the company's cooperation with the SEC's investigation, however, no civil penalty was imposed, although the SEC reserved the right to reopen the matter.

Activist Investor Groups

On February 14, 2017, the SEC announced an enforcement action against a group of activist investors for violation of the beneficial reporting requirements of the Exchange Act, including Sections 13(d)(1), 13(d)(2) and 16(a), and Rules 13d-1, 13d-2, 16a-2 and 16a-3. The investors were individuals who acted as financial professionals, along with their related investment entities. The investors included Jeffrey Eberwein (Eberwein); a hedge fund adviser led by Eberwein, Lone Star Value Management, LLC (Lone Star); Charles Gillman (Gillman); a private fund advised by Gillman, Boston Avenue Capital, LLC (Boston Avenue); and Heartland Advisors, Inc. (Heartland). The investors occasionally acted together to engage in shareholder activist campaigns targeting microcap companies, and the enforcement action related to five separate incidents involving allegedly inadequate disclosure by the investors.

Digirad, Inc.

In February 2011, Heartland filed an amended Schedule 13G disclosing 9.4% beneficial ownership in Digirad, Inc., which certified that the shares were not held for the purpose or effect of influencing control of the issuer. During the next year, Heartland and Gillman began discussions with Digirad to gain board representation. In

February 2012, Heartland amended its Schedule 13G to note a change in its interest; however, it did not file a Schedule 13D to supersede the Schedule 13D to disclose its intent to influence control of the company. The SEC asserted that Heartland violated Section 13(d)(1) of the Exchange Act and Rule 13d-1.

Aetrium, Inc.

In August 2012, Eberwein, Gillman, Boston Avenue and others formed a group to acquire, hold and vote shares of Aetrium, Inc. The group's Schedule 13D and amendments contained identical, generic language that the group may discuss ideas that, if put into effect, may result in an extraordinary corporate transaction. The group repeatedly discussed plans to sell off the company's existing line of business and convert the company into an acquisition shell. The group eventually engaged in a proxy fight with the company, which resulted in the group's gaining several board seats. According to the SEC, Eberwein did not comply with Item 4 of Schedule 13D because he failed to adequately disclose the group's purpose.

NTS, Inc.

In September 2012, Eberwein entered into a shareholder group agreement with a 5.5% shareholder and other business associates, including Gillman and Boston Avenue. The group failed to file a required Schedule 13D until almost six weeks later. The delayed filing of the Schedule 13D was done at Eberwein's suggestion to give the group time to buy more stock and intentionally allow the issuer less time to engage in defensive measures. During this time, Eberwein purchased a 5.34% stake in the company. According to the SEC, Eberwein's failure to timely file a Schedule 13D providing the required disclosure was a violation of Section 13(d)(1) and Rule 13d-1 of the Exchange Act. Additionally, as a member of a group with greater than 10% beneficial ownership, Eberwein was also subject to the requirements of Section 16(a) of the Exchange Act and failed to timely file an initial statement of beneficial ownership on Form 3 and changes in beneficial ownership on Form 4.

Analysts International Corp.

In December 2012, Heartland filed a Schedule 13D disclosing a 9.4% interest in Analysts International Corp. and stating that it had sent a shareholder proposal to be included in the company's proxy statement. After the company refused to include the proposal, Heartland started to work with Gillman, Boston Avenue and Eberwein, but failed to disclose that the parties were working together as a group. Together, the group accumulated a 4.35% interest in the company, with a total beneficial ownership of 13.75% by August 2013. According to the SEC, Heartland failed to timely amend its Schedule 13D to disclose the formation of the group and its total beneficial ownership, which violated Section 13(d)(2) and Rule 13d-2(a). Eberwein, Gillman and Boston Avenue failed to timely file a Schedule 13D disclosing their group beneficial ownership of the company's common stock. These failures were violations of Section 13(d)(1) and Rule 13d-1.

Hudson Global, Inc.

In May 2013, Heartland and Gillman began discussing potential group activism, including changes to the board of directors of Hudson Global, Inc. (Hudson). Heartland introduced Gillman to Hudson's board as a potential director, and independently, Gillman began to update Eberwein on discussions between him and Heartland involving Hudson. At this time, none of the parties owned shares of Hudson's common stock. Eberwein then met with a large Hudson shareholder and management and updated Gillman on the meetings. Eberwein then began purchasing shares of Hudson's common stock for Lone Star in October 2013. Gillman also shared his research on Hudson with Eberwein. In November 2013, Heartland and Gillman began negotiating a shareholder group agreement, and Gillman updated Eberwein on the negotiations. Gillman then purchased a 0.7% interest in Hudson's common stock.

In December 2013, Heartland, Gillman and additional parties associated with Gillman filed a Schedule 13D to disclose their agreement to push for corporate governance changes at Hudson and to disclose their total beneficial ownership of 14.6%. Gillman and Eberwein shared research and discussed targets for activism, and

in late December, Eberwein began a proxy fight with Hudson. Eberwein, Lone Star and two Eberwein associates filed a group Schedule 13D in January 2014, nominating Eberwein and an associate as Hudson director candidates and disclosing total beneficial ownership of 6.8%. Eberwein's group also filed an amended Schedule 13D in May 2014. Neither Schedule 13D listed Gillman as a group member. Due to the sharing of research and other coordination between Eberwein and Gillman, Gillman acted as a member of Eberwein's group. As a member of Eberwein's group, Gillman allegedly failed to timely amend his Schedule 13D to disclose the group and its beneficial ownership. In addition, the SEC said that Eberwein and Lone Star failed to timely file a Schedule 13D in January 2014 disclosing the group's complete membership and collective beneficial ownership.

In response to the enforcement action, the SEC accepted an offer of settlement with the parties under which they agreed to pay penalties of $90,000 for Eberwein, $30,000 for Gillman, $120,000 for Lone Star, and $180,000 for Heartland.

Conclusion

Shareholder activism has become more common in the life of the public company, and it is not surprising that the SEC has begun to hone in on activist campaigns as a new area of heightened enforcement attention. Activist investors are sometimes criticized for providing boilerplate or incomplete disclosures concerning their investment intent leading into a campaign, and the Section 13/Section 16 enforcement cases are welcome reminders that the SEC continues to monitor this area. Many companies, however, will view the civil penalties imposed on the activists as an inadequate "slap on the wrist."

But as the other two enforcement actions demonstrate, it is not just the activists who should be on guard. The other two cases targeted public companies over disclosures they made while facing hostile takeovers. These two cases are notable not only for some of the aggressive interpretive positions that the SEC took with respect to its disclosure regulations, but also because they call into question several common market practices concerning disclosure around competing negotiations and the commercial relationship with a company's financial advisors.

All three actions underscore the importance of providing contextually complete and accurate disclosure of material information while avoiding generic or ambiguous narrative, especially when the transaction structure and dynamics are complex. Both issuers and investors should keep these enforcement actions top of mind as they approach the next activist campaign or hostile takeover transaction.

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