PAUL HASTINGS

December 2023

Public Company Watch

Key Issues Impacting Public Companies

SEC Spotlight

Fall 2023 Regulatory Agenda Released

On December 6, 2023, the SEC's fall 2023 regulatory agenda was released. The agenda updated the timeline for anticipated SEC action on a number of topics, some of which have now been pushed back multiple times, as further explored in the SEC Rulemaking Tracker on page 6. The timeframes referenced in the regulatory agenda reflect the SEC's general rulemaking priorities, but should not be taken as definitive guidance on exact anticipated timelines. Final and proposed rules can be released prior to the anticipated rulemaking date, and are often pushed out until a future date. Of particular note for public companies are the updated rough timelines with respect to the following rules, which will likely become final in the first half of 2024:

- **Climate Change Disclosure**: The initial climate change rule was first proposed in March 2022, and mandated significant new disclosure that would impose a heavy lift on issuers in order to comply, including adding a new Regulation S-X article and a new sub-part to Regulation S-K. The SEC received thousands of comments on the proposed rule and has faced heavy backlash regarding the scope of disclosure suggested, which has resulted in the final rule being pushed back a number of times. We anticipate that the final rule will represent a toned-down version of the initial proposed rule.
- **SPAC Regulation**: The initial SPAC rules were also proposed in March 2022. They signaled an overhaul of the regulation of the SPAC vehicle, also included a new sub-part to Regulation S-K and a new article to Regulation S-X, and resulted in a chill on the COVID-era SPAC boom. As market participants have absorbed the scope of regulation proposed by the new rules, new best practices have evolved anticipating their finalization.
- **Amendments to Rule 14a-8**: The SEC's proposed revisit of the shareholder proposal exclusions was first proposed in July 2022 and impacts the substantial implementation exclusion, the duplication exclusion and the resubmission exclusion. The rules were designed to increase shareholders' ability to present varied perspectives on how to address similar issues by setting forth a more understandable structure for the SEC's application of the exclusions in the no-action letter process.

The SEC continued to extend the date for which it anticipates releasing proposed rules for key areas pertinent to public companies like corporate board diversity disclosure, human capital management disclosure, the Rule 144 holding period, the definition of "Held of Record" and Reg D and Form D improvements.

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Cybersecurity Real-Time Disclosure Reminder and Recent C&DIs

As of December 18, 2023, all issuers other than smaller reporting companies (SRCs) need to comply with new Item 1.05 of Form 8-K or the equivalent disclosure in Form 6-K for foreign private issuers. For a full description of the disclosure required pursuant to new Item 1.05 of Form 8-K or Form 6-K, as applicable, please see our **client alert**. SRCs will have until June 15, 2024 to comply.

In addition, during the week of December 11th, the SEC's Division of Corporation Finance released a series of C&DIs related to new Item 1.05 of Form 8-K. Each of the C&DIs is centered on the mechanics of the delay provision set forth in Item 1.05(c), which enables companies to postpone disclosure under the item if the U.S. Attorney General determines that disclosure poses a "substantial risk to national security or public safety" and notifies the SEC within the requisite time period. The general theme of the C&DIs is that if the U.S. Attorney General fails to make a determination and notify the SEC before the applicable deadline (i.e., within four business days of the determination that an incident is material or within four business days of the expiration of the delay period in the case of an issuer seeking an extension of the delay period, etc.), the issuer must file the Form 8-K prior to the deadline's passage. In addition, the SEC has specified that merely engaging with the U.S. Attorney General regarding the availability of the delay provision does not necessitate a finding that the cybersecurity incident was material.

Share Repurchase Rules Update

In last month's Public Company Watch, we discussed the recent *Chamber of Commerce v. the SEC* case in which the Fifth Circuit Court of Appeals held that the SEC "acted arbitrarily and capriciously" and in violation of the Administrative Procedure Act when it adopted the final share repurchase rules without addressing the contents of the petitioner's SEC comment letter, which provided guidance on how the SEC could quantify the economic impact of the proposed rule, and subsequently "failed to conduct a proper cost-benefit analysis" regarding the new rules. Pursuant to the order the SEC had thirty days to address defects in the rule, which had previously become effective and which generally called for compliance beginning with an issuer's first periodic filing that covers a full fiscal quarter beginning on or after October 1, 2023.

On November 22, 2023, the SEC stayed the effectiveness of the new share repurchase rules pending further action and asked the Fifth Circuit Court of Appeals for additional time to correct the defects identified with the rule. The Fifth Circuit subsequently denied the extension request, and the Chamber later filed a motion to vacate the amended share repurchase rules. On December 19, 2023, the Fifth Circuit vacated the amended share repurchase rules, meaning companies will no longer need to comply with any of the rule changes adopted in the share repurchase release, including the: (1) daily repurchase table (Exhibit 26 for corporate issuers who file on domestic forms or Form F-SR for FPIs that file on FPI forms); (2) checkbox disclosure indicating whether Section 16 officers and directors traded in issuer securities in the four business day period before or after the issuer's public announcement of a repurchase plan or program; (3) enhanced narrative disclosures related to an issuer's repurchase programs and practices; and (4) disclosure of an issuer's adoption or termination of a Rule 10b5-1 plan.

The SEC Announces Fiscal Year 2023 Year-End Enforcement Results

On November 14, 2023, the SEC's Division of Enforcement **announced** its enforcement results for the 2023 fiscal year, which ended on September 30, 2023. Below is an overview of key areas of focus and notable actions:

- **Record-setting financial remedies**: The SEC obtained $4.949 billion in financial remedies, the second-highest amount in SEC history, below only the 2022 fiscal year record of $6.439 billion in financial remedies. The 2023 financial remedies included $3.369 billion in disgorgement and prejudgment interest and $1.580 billion in civil penalties. The SEC distributed $930 million to harmed investors in fiscal year 2023.

- **Increase in enforcement actions**: The SEC filed 784 enforcement actions in fiscal year 2023, 24 more actions than the SEC filed in **fiscal year 2022**.

- **Accountability and remedial measures against individual officers and directors**: The SEC stressed that individual accountability remains a pillar of the SEC's enforcement program. For fiscal year 2023, the SEC reported that it obtained orders barring 133 individuals from serving as officers and directors of public companies, the highest number of officer and director bars obtained in a decade. The SEC referenced several cases where, as part of the settled charges, individual officers and directors were barred from serving as an officer or director of a public company, including a former Wells Fargo executive, the former CEO of McDonalds, and Pareteum Corp.'s former controller.

- **Record-setting whistleblower rewards and reports**: The SEC issued whistleblower awards totaling nearly $600 million, the most ever awarded in one year, including a record-breaking $279 million awarded to one whistleblower whose information and assistance led to the successful enforcement of SEC and related actions. The SEC received more than 40,000 whistleblower tips, complaints, and referrals in fiscal year 2023, a 13% increase over fiscal year 2022. Highlighting its priority to protect and

encourage whistleblowers, the SEC took forceful action to protect whistleblowers' rights, including settling charges against a firm that attempted to impede employees' ability to report potential securities laws violations to the SEC.

- **Rewarding meaningful cooperation**: The SEC highlighted that it continues to reward meaningful cooperation, referencing several settled actions in fiscal year 2023 where the SEC imposed lower or no civil penalties on companies that self-reported misconduct. For example, the SEC referenced charges it settled against broker-dealer Perella Weinberg regarding recordkeeping failures. As Perella Weinberg self-reported, it paid a substantially lower civil monetary penalty than other firms that were charged as part of the initiative but had not self-reported.

Activism Update

Corporate America Beware: Labor Unions, Social Activists, and Universal Proxy Cards

On November 21, 2023, a coalition of labor unions led by the Service Employees International Union (SEIU), announced that it has nominated three director candidates for election to the Board of Directors of Starbucks at the 2024 annual meeting of shareholders. The coalition, which beneficially owns less than 0.00002% of the company's outstanding shares, is effectively using the campaign as a means to ratchet up its efforts to unionize Starbucks' workforce. The campaign is the logical consequence of the universal proxy rules implemented by SEC last year. As expected, such rules have opened the gates for social activists like labor unions to hijack the annual shareholder meeting process as a very public platform to pressure corporate management and advance their agendas. This campaign is a harbinger of the types of campaigns corporations can expect from labor unions and other single-agenda activists as these players adapt to the lower campaign costs made possible by the universal proxy rules. In the meantime, corporations should take meaningful actions to prepare. For more information regarding the SEIU's campaign and for our recommendations on appropriate advance-action corporations should be considering, please see our **client alert**.

Recent Rulings from Delaware Chancery Favorable to Companies in Shareholder Activism Context

Two recent rulings from the Delaware Court of Chancery relating to matters that frequently arise in proxy contests and activism settlement agreements were favorable to companies. In ***Paragon Technologies, Inc. v. Terence J. Cryan, et al.*** (November 30, 2023), Vice Chancellor Will denied an investor's request for a preliminary injunction that would have (1) required the board to let its candidates stand for election after the company rejected its advance notice of nomination and (2) permitted the investor to purchase more shares of the company pursuant to a request for an exemption to make such purchase under the company's NOL rights plan. In ***Texas Pacific Land Corporation v. Horizon Kinetics LLC, et al.*** (December 1, 2023), Vice Chancellor Laster ruled that the investor should have voted with the board's recommendation on a proposal in the company's proxy statement to increase the number of authorized shares of common stock pursuant to the terms of a stockholders agreement entered into connection with an activism campaign and deemed the shares to have been voted in favor of the proposal declaring the proposal approved. These cases show that Delaware courts continue to recognize the enforceability of advance notice bylaw provisions, the legitimacy of NOL rights plans, and the enforceability of contractual provisions in activism settlement agreements. For more information, please see our **client alert**.

M&A Update

Delaware Chancery Court Considers Limitations of Certain "Con Ed" Provisions

Decision: On October 31, 2023 the Delaware Court of Chancery, in an opinion by Chancellor McCormick, rejected a mootness fee petition brought by a former Twitter (n/k/a X) stockholder. The former stockholder sought the fee award based on the assertion that the former stockholder's claims contributed to Mr. Musk's decision to close the deal. The Court rejected the mootness fee petition on two alternative grounds: (i) that the stockholder lacked third-party beneficiary status for its asserted claims; and (ii) the stockholder's third-party beneficiary rights were limited to claims that, in this instance never vested. More specifically, in the claim at issue here (specific performance to compel a deal to close), a company alone has the right to bring such a claim, not its stockholders. Additionally, while the agreement could be read to grant stockholders a limited third-party beneficiary right to seek benefit-of-the-bargain damages had the deal failed to close, because the deal in fact closed and was not terminated, the stockholder's third-party beneficiary right was unavailable.

Takeaways: The decision could create ambiguity surrounding the enforceability and acceptable scope of so-called "Con Ed" provisions designed to insure stockholders receive the benefit of the bargain in any improperly terminated deal. Coming out of this decision, target company advisors should consider more clearly and expressly grant third party beneficiary status to Company

stockholders (with the potential issue of proliferating shareholder litigation claims and/or disproportionately enriching plaintiff's counsel) or in the alternative, reconsider the sizing of reverse termination fee or liquidated damage clauses, to more accurately reflect share premium or other benefits of the transaction to target shareholders. However, care must be paid such that fees are not of a size or magnitude that would cause courts to determine that they constitute an impermissible penalty fee. On a more long-term basis, the Court suggested that a target company could amend its charter to include a provision explicitly delegating its stockholders as the company's sole agent for the purpose of recovering lost-premium damages.

Other Regulatory Updates

Glass Lewis Releases Updated Guidelines for 2024 Proxy Season

On November 16, 2023, proxy advisory firm Glass Lewis released its 2024 Proxy Voting Policy Guidelines. The guidelines will apply to shareholder meetings occurring after January 1, 2024. For a summary of the salient changes for US public companies applicable in the upcoming proxy season under Glass Lewis's guidelines please see this **client alert**. We eagerly await ISS's updated U.S. Proxy Voting Guidelines for the 2024 proxy season.

FTC and DOJ Issue Final Merger Guidelines

On December 18, 2023 the FTC and DOJ jointly issued the 2023 Merger Guidelines, which describe the factors and frameworks the agencies utilize when reviewing mergers and acquisitions. The first draft was issued in July, and in the following months the agencies hosted several workshops and received over 30,000 comments from "consumers, workers, academics, interest organizations, attorneys, enforcers, and many others." The final reflects some of that feedback. The final version reduces the 13 originally proposed guidelines down to 11, removing and merging some of the guidelines in the final. Among other changes, the final version eliminates the draft appendix of economic analysis in favor of a section outlining "a non-exhaustive discussion of analytical, economic, and evidentiary tools the Agencies use to evaluate facts, understand the risk of harm to competition, and define relevant markets." Many critics say the changes from the draft to final copy are mostly stylistic in nature, including the removal of the biblical-like "thou shall not" phrasing at the top of each guideline. Importantly, the final merger guidelines maintain the lower market share concentration levels as the July version, opening more transactions to scrutiny and potential challenge. That includes the presumptions that a deal likely would lead to too much industry concentration if it would give the combined firm a more than 30% market share, if a newly vertically integrated company would gain control of 50% of a related market, and if a deal reaches a lower concentration threshold than the one identified in the 2010 guidelines the new version replaces.

FTC Pursues Improper Orange Book Listings

In September 2023, the FTC issued a policy statement warning branded drug manufacturers that it would scrutinize improper Orange Book patent listings as potential unfair method of competition in violation of Section 5 of the FTC Act. The Hatch-Waxman Act and FDA regulations set forth the criteria for listing patents in the Orange Book. As part of the Hatch-Waxman framework, brand drug manufacturers are required to submit information to the FDA about certain types of patents covering the products described in their new drug application. Patents listed in the Orange Book must claim the reference listed drug or a method of using it. The purpose of listing a patent in the Orange Book is to put potential generic manufacturers on notice that the brand considers the patent to cover its drug. By listing patents, brand drug manufacturers may benefit from a 30-month stay of FDA approval of generic drug applications, regardless of whether a court ultimately finds the patent at issue is valid or infringed by the competing product. According to the FTC's policy statement, "certain manufacturers have submitted patents for listing in the Orange Book that claim neither the reference listed drug nor a method of using it. When brand drug manufacturers abuse the regulatory processes set up by Congress to promote generic drug competition, the result may be to increase the cost of and reduce access to prescription drugs."

Making good on its promise, on November 7, 2023 the FTC sent letters to 10 brand-name drug companies accusing them of improperly listing more than 100 patents in the Orange Book. The FTC stated it would take steps to dispute the Orange Book listings, though it has not initiated any Section 5 enforcement actions or other antitrust challenges against these Orange Book patent listings to date. Instead, the FTC wrote that "we have opted to use the FDA's regulatory dispute process to address the improper listings, but we retain the right to take any further action the public interest may require."

Under the FDA's Orange Book dispute resolution process, the companies have 30 days to respond by recertifying the patents, otherwise they can allow them to be stripped from the Orange Book. If the FTC's letters successfully deter the companies from recertifying the patents in the Orange Book, many products currently protected by those patents could be subject to swift generic competition. If the branded drug manufacturers re-certify the patents, they run the risk of being sued by the FTC under the FTC Act as an unfair method of competition, or being referred to the Department of Justice for criminal prosecution for submission of false statements.

Key Takeaway: The FTC aims to promote generic competition for brand-name drugs to provide "lower prices, increased access, and significant cost savings for consumers and the healthcare system." This recent action under the FDA's Orange Book dispute process is yet another example of the FTC utilizing all tools available in furtherance of its heightened antitrust enforcement mandate. The FTC Deputy Director has said that the FTC will continue to review other patent listings and that this action is not exhaustive. Pharmaceutical companies would be well-advised to take extra caution to ensure that they have a good faith basis for concluding their Orange Book listings satisfy the listing criteria.

New California Law Imposes Anti-Greenwashing Disclosure Requirements Starting in January 2024

California has a new climate bill targeting corporate greenwashing that imposes disclosure requirements starting on January 1, 2024. The Voluntary Carbon Market Disclosure Act (AB 1305) establishes three different disclosure requirements:

- First, entities that operate in California and make claims that they "[do] not add net carbon dioxide or greenhouse gases . . . to the climate or ha[ve] made significant reductions to [their] carbon dioxide or greenhouse gas emissions," will have to disclose information on their website as to how the claim was determined to be accurate or accomplished and how interim progress towards the goal is being measured, as well as whether there is independent third-party verification of the company data and claims made.
- Second, entities operating in California that purchase or use carbon offsets and make claims that they do not add GHGs to the climate, or that they have significantly reduced their GHG emissions, will have to provide information on their website regarding the carbon offset program and whether there is third-party verification of the claims.
- Finally, entities that market or sell carbon offsets within California— regardless of whether they operate in the State—will have to make extensive and detailed disclosures on their websites regarding the applicable carbon offset project, accountability measures if a project is not completed or does not meet the projected emissions reductions or removal benefits (including actions the entity shall take if carbon storage projects are reversed or future emissions reductions do not materialize), and pertinent data and calculation methods needed to independently reproduce and verify the emissions reduction or removal credits issued using the protocol.

Key Takeaway: AB 1305's disclosure requirements become effective on January 1, 2024 and entities that are not in compliance can be fined up to $2,500 a day with a maximum penalty of $500,000. There is no private right to sue to enforce AB1305's provisions, but the government (e.g., the California Attorney General or a district attorney) can bring a civil action to enforce penalties on violators and private plaintiffs may have a basis to sue for misstatements under other state or federal statutes. Therefore, entities that either market or sell VCOs in the state, or operate in California, even in a limited capacity, and make related claims should immediately assess whether any existing statements in investor materials, marketing, and websites, among other media, may be covered by AB1305's requirements, and prepare the required disclosures to be in compliance. For additional information, please see our **client alert**.

Litigation Corner

Potential Limitations on the SEC's Ability to Seek Disgorgement

Summary: The U.S. Court of Appeals for the Second Circuit recently issued a decision which could have important implications for the SEC when seeking disgorgement. In *Securities and Exchange Commission v. Govil,* No. 22-1658, 86 F.4th 89 (2d Cir. 2023), the Second Circuit held that disgorgement is an equitable remedy and is only available where defrauded investors have suffered pecuniary harm. The *Govil* decision arrives in the wake of *Liu v. SEC,* 140 S. Ct. 1936 (2020), in which the U.S. Supreme Court held the SEC could seek disgorgement as an equitable remedy under 15 U.S.C. § 78u(d)(5) if the disgorgement award "does not exceed a wrongdoer's net profits *and is awarded for victims*[.]" (emphasis added).

Facts: The *Govil* case involved claims against Aron Govil, the founder and CEO of Cemtrex, Inc. for allegedly fraudulently misrepresenting to investors he would use proceeds from three securities offerings to satisfy outstanding debts and for various corporate purposes, when he instead diverted over $7.3 million from the offerings to his own private accounts. After entering into a settlement agreement with Cemtrex in which Govil agreed to surrender his Cemtrex securities to the company and pay the company $1.5 million in the form of a promissory note, Govil entered into a Consent Agreement with the SEC, which included the entry of judgment against Govil for securities fraud and left to the district court a determination of additional monetary remedies. After securing a partial judgment against Govil, the SEC moved for additional disgorgement from Govil of approximately $7.3 million. Over Govil's opposition, the district court credited the $1.5 million due under the promissory note, but disregarded the securities surrendered by Govil and awarded the SEC disgorgement of approximately $5.8 million. Govil appealed the disgorgement ruling

on the grounds that the allegedly defrauded investors were not "victims" under *Liu* and because the district court failed to credit the value of the securities he surrendered against the disgorgement award.

Decision: In its decision, the Second Circuit vacated the order by the district court and remanded the case for further fact finding. The Court concluded that under *Liu,* the disgorgement remedy is only available if it can be awarded to "victims," which it defined as investors who had suffered pecuniary harm. In so holding, the court reversed the district court's determination that to qualify as a "victim," "it was sufficient that the investors were told a 'lie'" because "[t]he investors were thus denied the right to make an informed decision when considering whether to make the investment." The Second Circuit rejected this reasoning, explaining that a determination as to whether investors suffered pecuniary harm requires the court to consider "the type of securities held, the terms of those securities, and when those securities were sold." The Court also noted that in private securities fraud actions, an investor must prove an economic loss and recognized that "[w]ere we to call those investors [who could not pursue individual fraud claims] 'victims' without a similar showing, we would allow the SEC to forward proceeds of disgorgement to such investors and circumvent the limitations on private claims under § 10(b) [of the Securities Exchange Act] and the common law."

Key Takeaway: The *Govil* decision is significant, as going forward, at least in the Second Circuit, the SEC's ability to seek disgorgement will be more limited. Although the holding in *Govil* does not entirely preclude the SEC from seeking disgorgement as a remedy, it will require a fact-intensive inquiry into whether the allegedly defrauded investors suffered any pecuniary harm.

SEC Rulemaking Tracker

Recently Adopted Rulemaking		
Modernization of Beneficial Ownership Reporting	Significant amendments to modernize the filing deadlines for initial and amended beneficial ownership reports on Schedules 13D and 13G	The rules will be effective 90 days after publication in the Federal Register Filers will have until September 30, 2024 to comply with the revised Schedule 13G filing deadlines and until December 18, 2024 to comply with the structured data requirements
Cybersecurity and Risk Governance	Amendments requiring current reporting of material cybersecurity incidents and annual disclosure related to an issuer's cybersecurity risk management system, including the board's and management's role therein	Final rule adopted July 26, 2023, effective September 5, 2023 Compliance with current reporting requirements for filers other than SRCs as of December 18, 2023, and as of June 15, 2024 for SRCs. Compliance with annual reporting requirements in annual reports for fiscal years ending on or after December 15, 2023. Issuers must comply with Inline XBRL tagging requirements in current reports as of December 18, 2024 and for annual reports for fiscal years ending on or after December 15, 2024
Share Repurchase Modernization	Amendments requiring quarterly tabular disclosure of daily share repurchases and related narrative disclosures	Vacated by Fifth Circuit on December 19, 2023

10b5-1 Plans and Insider Trading	Series of changes revamping conditions to be met in order for a person to rely on the affirmative defense from insider trading available under Rule 10b5-1(c)(1), requiring related quarterly and annual disclosures and impacting Form 4 / 5 filings	Amendments to Forms 4 / 5 effective as of April 1, 2023 Compliance with the new disclosure requirements generally required in the first filing that covers the full fiscal period that starts on or after April 1, 2023 (or after October 1, 2023 for SRCs) Clarified in C&DI to mean, for December 31 fiscal year-end companies (that are not SRCs): • Quarterly disclosures in Form 10-Q for period ended June 30, 2023 • Annual disclosures in Form 10-K or 20-F for the fiscal year ended December 31, 2024 • Proxy / Information Statement disclosures for first annual meeting for election of directors after the completion of the first full fiscal year beginning on or after April 1, 2023
Compensation Clawbacks	Requires adoption of / compliance with clawback policy in connection with erroneously awarded incentive-based compensation	Effective October 2, 2023, meaning issuers will be required to include disclosures in relevant SEC filings after that date and to adopt and adhere to compliant clawback policies as of December 1, 2023
Pending Rulemaking[1]		
Climate Change	Comprehensive climate-change-related disclosure overhaul impacting registration statements and periodic reports and related notes to financial statements	Awaiting final action; pushed back again until April 2024
SPACs	Comprehensive changes overhauling regulation of SPAC structure	Awaiting final action; pushed back again until April 2024
Rule 14a-8	Potential amendments regarding updating bases for exclusion of shareholder proposals under the substantial implementation exclusion, the duplication exclusion and the resubmission exclusion	Awaiting final action; pushed back until April 2024
EDGAR Filer Access and Account Management	Comprehensive technical changes to EDGAR referred to as EDGAR Next	Awaiting final action; no timeline provided
Anticipated Rulemaking		
Corporate Board Diversity	Potential rulemaking requiring disclosure regarding diversity of board members and director nominees	Pushed back again until October 2024
Human Capital Management	Additional rulemaking enhancing disclosures regarding human capital management (beyond what is already required by an issuer's Business section)	Pushed back again until April 2024

1 Note that the projected dates for the pending and anticipated rulemaking are based on the SEC's most recent Regulatory Flexibility Agenda.

Reg D and Form D Improvements	Updates to Reg. D exemption for private placements, including to definition of “accredited investor” and Form D	Pushed back again until April 2024
Revisiting Definition of “Held of Record”	Revisiting definition of “held of record” used in Section 12(g) of Exchange Act (i.e., for determining whether an issuer will need to register its equity securities with the SEC)	Pushed back again until April 2024
Rule 144 Holding Period	Potential amendments to resale safe harbor for restricted / control securities	Pushed back again until October 2024
Incentive-Based Compensation Arrangements	Potential re-proposal of regulations regarding incentive-based compensation practices at certain financial instructions with over $1 billion in total assets	Anticipated release of re-proposed rule April 2024

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