PAUL HASTINGS

November 2023

Public Company Watch

Key Issues Impacting Public Companies

SEC Spotlight

Preparing for 2024 Annual Reporting Season

As we head into year-end, annual reporting season is just around the corner. Over the past twelve months, the SEC has been active on the rulemaking front, resulting in numerous new disclosure obligations for issuers during the 2024 annual reporting season. Public companies should be aware of the new disclosures required and should build time into their reporting calendars to prepare, review and tag the disclosures. Please see our **client alert** for an in-depth dive into how to prepare for annual reporting season.

Clawback Reminder

Public companies should be on alert—Friday, December 1, 2023 is fast-approaching and all US-listed issuers, including foreign private issuers, must have adopted an exchange compliant policy by that date, covering all incentive-based compensation received on or after October 2, 2023. In addition, by December 31, 2023, NYSE-listed companies must confirm on Listing Manager that they have adopted a clawback policy or otherwise assert their reliance on an applicable exemption.

For a summary of the clawback-related developments, please see the May edition of the Public Company Watch accessible **here**, the June edition of the Public Company watch accessible **here**, our client alert on the final SEC rules accessible **here** and our client alert on the exchanges initial proposed listing standards accessible **here**.

SEC Has 30 Days to Remedy Defects in Share Repurchase Rules Following Fifth Circuit Court Decision

On May 3, 2023, the SEC adopted new enhanced disclosure requirements for issuers' repurchases of equity securities. The amendments require issuers to provide certain quantitative and qualitative information on a quarterly basis, including among other things, daily repurchase data in a tabular format, and enhanced narrative disclosures related to an issuer's repurchase programs and practices, including the issuer's rationale for engaging in a share repurchase program. For additional information regarding the rules, please see our **client alert.**

On October 31, 2023, in ***Chamber of Commerce v. the SEC***, 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 final rules have not been invalidated; instead, the SEC has thirty days to address defects in the rule. The court retains jurisdiction to review the SEC's response and could still invalidate the rule.

In This Edition

SEC Spotlight 1

- Preparing for 2024 Annual Reporting Season
- Clawback Reminder
- SEC Has 30 Days to Remedy Defects in Share Repurchase Rules Following Fifth Circuit Court Decision

Activism Update 2

- 14a-8 No-Action Request Submission Form

Other Regulatory Updates 2

- Nasdaq Reverse Stock Split
- White House Passes Sweeping AI Executive Order
- California Employers Beware
- FTC Update: Revival of Robinson-Patman Act, Aggressive Third Party Discovery, and "Vigorous" Merger Enforcement
- New DOJ Guidance Regarding M&A Safe Harbor

Litigation Corner 4

- Supreme Court to Contemplate Whether SEC's Use of Administrative Law Judges Is Constitutional
- Supreme Court to Consider Whether Item 303 Violations Create a Private Right of Action

SEC Rulemaking Tracker 6

Given the uncertainty regarding the rules, calendar year-end companies should continue to prepare for compliance with the new disclosure requirements in their upcoming Form 10-K filing, and all other companies should prepare to comply with the rules in their next Form 10-Q filing.

Activism Update

14a-8 No-Action Request Submission Form

On November 7, 2023, the SEC's Division of Corporation Finance announced a new intake system for Rule 14a-8 submissions and related correspondence. Pursuant to the announcement, any Rule 14a-8-related correspondence must be submitted via the new online system accessible **here**. The intake form includes questions regarding the type of submission (i.e., initial or supplemental correspondence), the submitting party and their contact information, the bases for exclusion and other general information and enables users to upload a copy of the request or supplemental correspondence. In addition, the submission form asks for the company's anticipated proxy print date and includes a reminder that requests for exclusions of shareholder proposals must be filed with the SEC no later than 80 days prior to the definitive proxy statement filing date. The SEC will not accept emailed materials going forward.

Other Regulatory Updates

Nasdaq Reverse Stock Split

The SEC approved Nasdaq's rule changes regarding the timeframe and requirements for notification and disclosure related to reverse stock splits. Rather than following the "Substitution Listing Event" process, Nasdaq-listed companies seeking to implement a reverse stock split will be required to submit a Company Event Notification Form to Nasdaq by 12 pm ET five business days prior to the proposed market effective date, which should include a copy of the draft public disclosure regarding the reverse stock split as well as all information called for by the form. In addition, Nasdaq-listed companies are required to provide Reg FD compliant notice (e.g., Form 8-K, press release) regarding a reverse stock split in advance of 12 pm ET two business days prior to the proposed market effective date and follow standard pre-release procedures with the MarketWatch Department. In addition, the SEC also approved Nasdaq's proposed rule change establishing a regulatory halt in pre-market trading for securities subject to a reverse stock split, to enable Nasdaq and other market participants sufficient time to correct any errors with the ordering / quotation of the security subject to the split. Generally, Nasdaq anticipates it will "initiate the halt at 7:50 p.m., prior to the close of post-market trading at 8:00 p.m. on the day immediately before the split in the security becomes effective, and resume trading at 9:00 a.m. on the day the split is effective."

White House Passes Sweeping AI Executive Order

On October 30, 2023, the Biden-Harris Administration unveiled a sweeping **Executive Order on the Safe, Secure, and Trustworthy Development and Use of Artificial Intelligence (AI)**. The Executive Order represents the most significant action taken thus far by the Federal government to address the risks and challenges posed by the rapid development of AI systems. While the focus of the Executive Order is on AI risks, regulation, and development, it also addresses AI's extensive impacts on the federal government and various sectors and issue areas, such as healthcare, national security, critical infrastructure, and consumer protection. As public company boards consider their fiduciary duties with respect to the use of and / or decision whether or not to invest in AI technology, they should be aware of the general regulatory landscape tentatively being implemented to monitor AI use. For additional information, please see our **client alert**.

California Employers Beware

Last month, California Governor Gavin Newsom signed numerous bills into law with significant implications for employers. Most notably, the new California laws:

- Expand the paid sick leave law entitlement for employees from three days (or 24 hours) to five days (or forty hours);
- Prohibit employers from entering into or enforcing non-compete agreements with employees, regardless of where and when the agreement was signed, and require employers to notify current and former employees about unlawful non-compete covenants in their employment agreements;
- Allow eligible employees to take up to five days of unpaid leave following a "reproductive loss event" (i.e., adoption, failed surrogacy, miscarriage, stillbirth, or unsuccessful assisted reproduction);

- Require employers to adopt comprehensive workplace violence prevention plans; and
- Prohibit employers from discriminating against applicants and employees for: (1) off-duty cannabis use away from the workplace; or (2) a drug test that identifies only non-psychoactive cannabis metabolites in the applicant's hair, blood, urine, or other bodily fluids, and further, prohibit employers from requesting information from job applicants relating to their prior use of cannabis.

Due to the flurry of legislative changes on the horizon, both California-based employers and out-of-state-employers with employees in California should promptly review their policies, procedures, and practices to ensure compliance with these new laws. For additional information, please see our **client alert**.

FTC Update: Revival of Robinson-Patman Act, Aggressive Third Party Discovery, and "Vigorous" Merger Enforcement

Robinson-Patman Act: The FTC's aggressive antitrust enforcement efforts have expanded in recent months. The FTC has recently launched at least two investigations in an effort to enforce the Robinson-Patman Act (the "RPA"), a statute that the government has not enforced in over two decades (for more information see our **client alert**). The RPA is an antitrust law that protects competition by preventing sellers from charging competing buyers different prices for the same goods, commonly referred to as price discrimination. The RPA was designed to protect smaller, often independent, businesses whose ability to compete is threatened by their relative purchasing power compared to a larger rival that may be able to negotiate large discounts. The FTC is currently investigating two major providers of soft drinks and Southern Glazer Wine and Spirits in relation to its distribution of wine and liquor. The FTC reportedly initiated the Southern Glazer's investigation after receiving complaints from participants in the alcohol production, distribution, and retail industry. The revival of the RPA is unique in that the DOJ and FTC for decades have focused their energies and resources to scrutinize potential antitrust violations in line with the consumer welfare standard, that being to protect consumers rather than competitors. This yet another example of the agencies using all of the tools in their toolbox in response to President Biden's 2021 call to action for heightened antitrust enforcement. Companies offering consumer goods may need to evaluate their existing sales and marketing policies to identify potential exposure.

Third Party Discovery: Notably, specifics of the Southern Glazer's investigation by the FTC were uncovered in the FTC's petition to enforce a civil investigative demand ("CID") it issued to Total Wine & More. Total Wine challenged the CID as overly burdensome, particularly insofar as it sought information allegedly unconnected to the Southern Glazer's relationship with Total Wine. While the FTC is usually able to negotiate third party discovery by minimizing burdens, the agency evidently was unable to reach any common ground, resulting in a breakdown in discussions and now the FTC taking Total Wine to federal court to enforce compliance. CID enforcement actions by the FTC and DOJ such as this are rare. The agencies have broad authority to issue third-party CIDs in furtherance of their antitrust investigations. As the agencies continue to expand their antitrust enforcement efforts, they have similarly expanded the scope of the CIDs they issue and are in many cases insisting on strict compliance. Companies that are on the receiving end of FTC discovery requests should expect increased rigidity in negotiating responses with agency staff and should carefully consider their CID compliance efforts.

Merger Enforcement: The FTC is reportedly remaining fully booked in its merger investigations, adding at least two Second Request investigations to its docket in the last month. In a letter responding to questions from Congressman Thomas P. Tiffany, FTC Chair Lina Khan defended the agency's record in its "vigorous" pursuit of antitrust enforcement. She recounted the results of the 38 actions her office has taken on proposed mergers. Nineteen mergers were abandoned, divestitures were agreed to in 14 cases "to prevent the mergers from resulting in harm," significant alterations were made to one deal, a consent order was agreed to in another, two actions are pending, and the FTC withdrew one action after its challenge failed in federal court. Khan argues the FTC's "enforcement record reveals that the Commission has been pursuing strong cases, well within established precedent and with solid facts and compelling economic analysis." Skeptics argue the FTC is wasting taxpayer money in furtherance of Khan's radical agenda to overhaul antitrust law that will ultimately result in harm to consumers.

New DOJ Guidance Regarding M&A Safe Harbor

The DOJ recently announced a new M&A Safe Harbor Policy providing a "presumption of a declination" when companies "disclose misconduct discovered at the acquired entity within six months from the date of closing" and "fully remediate the misconduct" within one year. DOJ noted that certain facts and circumstances may justify extending these timelines. The new policy is Department-wide, so companies can expect individual DOJ divisions to tailor the policy to their own enforcement polices and framework.

This announcement is consistent with and formally adopts the DOJ's existing approach to successor liability in M&A transactions. Deputy Attorney General Lisa Monaco (the "DAG") openly acknowledged this, referencing the 2002 Opinion Procedure Release 08-02 (referred to as the "Halliburton Opinion Release"), which has long helped guide companies approach to post-acquisition due diligence. The new timelines are very similar to those articulated in Halliburton Opinion Release. Furthermore, DOJ has repeatedly emphasized the need for companies to conduct pre- and post-close due diligence to promptly identify, disclose, and remediate potential violations.

In addition to continuing emphasis on appropriate pre- and post-close due diligence and integration, companies are advised to review their M&A due diligence procedures to ensure they meet these now formalized post-close due diligence and remediation timelines, assess whether they have fully accounted for the range of compliance risks that fall under the policy, and monitor for additional guidance from individual DOJ divisions. Companies also are wise to engage experienced counsel early, particularly in complex and large transactions, which may not meet these timelines, thereby justifying an extension.

For more information please see our **client alert.**

Litigation Corner

Supreme Court to Contemplate Whether SEC's Use of Administrative Law Judges Is Constitutional

On June 30, 2023, the Supreme Court granted the SEC's petition for writ of certiorari in *Securities and Exchange Commission v. Jarkesy*, No. 22-859. At issue in the case is whether the SEC's use of administrative law judges ("ALJs") is unconstitutional. Three issues are now pending before the court: first, whether statutory provisions that empower SEC to initiate and adjudicate administrative enforcement proceedings seeking civil penalties infringes on the Seventh Amendment's right to a jury trial in civil lawsuits; second, whether statutory provisions that authorize the SEC to choose to enforce the securities laws through an agency adjudication instead of filing a district court action violate the non-delegation doctrine; and third, whether Congress violated Article II by granting for-cause removal protection to ALJs in agencies whose heads enjoy for-cause removal protection. Oral argument is currently sent in this case for Wednesday, November 29, 2023.

Supreme Court to Consider Whether Item 303 Violations Create a Private Right of Action Under Section 10(b)

Introduction: On September 29, 2023, the Supreme Court agreed to hear an appeal from the Second Circuit to resolve a split between the circuits over whether a failure to make a disclosure required under Item 303 of Regulation S-K––Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A")––standing alone, is sufficient to give rise to a private right of action under Rule 10b-5. Specifically, the Supreme Court was asked to address: "Whether the Second Circuit erred in holding—in conflict with the Third, Ninth, and Eleventh Circuits—that a failure to make a disclosure required under Item 303 can support a private claim under Section 10(b), even in the absence of an otherwise-misleading statement."

Item 303 of Regulation S-K: Item 303 of Regulation S-K is an administrative rule that requires companies to describe as part of their periodic reports to the SEC, "any known trends or uncertainties that have had or that the registrant reasonably expects will have a materially favorable or unfavorable impact" on the company. *See* 17 C.F.R. § 229.303(a)(3)(ii). The SEC has issued guidance stating that a company must make a disclosure under Item 303 regarding certain information "where a trend, demand, commitment, event or uncertainty is both presently known to management and reasonably likely to have material effects on the registrant's financial conditions or results of operations." *See* Management's Discussion and Analysis of Financial Condition and Results of Operations at 14, Exchange Act Release No. 6835, 43 S.E.C. Docket 1330 (May 18, 1989). In 2020 when the SEC amended Item 303, it set a "reasonably likely" threshold in certain provisions of MD&A and indicated that the analysis included in MD&A should be based on objective reasonableness.

Item 303 does not provide explicitly a private right of action for investors to sue if these disclosure requirements are not met—it only serves as the basis for an SEC enforcement action.

***Moab Partners, L.P. v. Macquarie Infrastructure Corp.* and the Circuit Split:** In 2018, investor Moab Partners, L.P. ("Moab") filed a class action lawsuit against Macquarie Infrastructure Corp. ("MIC"), in the United States District Court for the Southern District of New York, alleging that MIC made false statements and omissions to investors regarding the possible ramifications of new international regulatory laws which would ban one of the fuels that MIC stored, No. 6 oil. *City of Riviera Beach Gen. Emps. Ret. Sys. v. Macquarie Infrastructure Corp.*, No. 18-CV-3608 (VSB), 2021 WL 4084572 (S.D.N.Y. Sept. 7, 2021). If passed, the regulations would have long-term negative consequences on MIC's business. After the new law came into effect, MIC's stock price declined.

Plaintiffs alleged violations of Section 10(b) and Rule 10b-5, among others. Specifically, Moab alleged that MIC was required but failed to disclose (a) MIC's reliance on revenue from the storage of No. 6 oil, (b) the risk that implementation of the regulations "would severely curtail 'the demand for storage'" of No. 6 oil, and (c) the risk that MIC would "need to undertake significant capital expenditures to repurpose" some of its tanks in response to market conditions.

The defendants moved to dismiss the complaint for failure to state a claim, and the district court granted the motion. The Court rejected Moab's argument that MIC violated a disclosure obligation under Item 303 of SEC Regulation S-K. The Court held that Plaintiffs failed to "plead facts supporting an inference that Defendants had actual knowledge of a material trend or uncertainty facing MIC's No. 6 fuel oil storage business, and that it had this knowledge early enough to require disclosure in some pre-February 2018 securities filing," and that the Complaint fell "short of pleading facts showing that Defendants' statements were "not honestly believed when they were made." *Id*. at *10.

Plaintiffs appealed, and the Second Circuit reversed, holding that Moab had alleged actionable omissions for purposes of Section 10(b). *Moab Partners, L.P. v. Macquarie Infrastructure Corp.*, No. 21-2524, 2022 WL 17815767, at *3 (2d Cir. Dec. 20, 2022). The panel "agree[d] with the district court that the majority of Defendants' alleged misstatements are not actionable," but it concluded that Moab "ha[d] adequately alleged a 'known trend[] or uncertaint[y]' that gave rise to a duty to disclose under Item 303." *Id*. at *2-*3.

In their petition for certiorari, Defendants highlighted how the Second Circuits' decision in Moab contradicts the holdings of four other circuits, all of which have held that a violation of Item 303, standing alone, does not create a private right of action under Section 10(b). The Third Circuit was the first court of appeals to address the intersection between Item 303 and Section 10(b) in *Oran v. Stafford*, 226 F.3d 275 (3d Cir. 2000). The explained that there are two ways in which an Item 303 violation could confer a private right of action. First, an Item 303 violation could be actionable if Item 303 "create[d] an independent private right of action," but neither "the language of the regulation nor the SEC's interpretative releases construing it" supported one. *Id*. at 287. Second, there could be liability under Section 10(b) if Item 303 "impose[d] an affirmative duty of disclosure . . . that, if violated, would constitute a material omission under Rule 10b-5." *Id*. But this path was not viable either, as "the materiality standards for Rule 10b-5 and [Item] 303 differ significantly." *Id*. at 288.

The Third Circuit recognized that these disclosure obligations "extend considerably beyond those required by Rule 10b-5" under Basic's materiality test. *Id*. (quotation and citation omitted). "Because the materiality standards for Rule 10b-5 and [Item]303 differ significantly," the court held that a violation of Item 303's disclosure requirement "does not automatically give rise to a material omission under Rule 10b-5." *Id*. A "duty to disclose" under Rule 10b-5 "must be separately shown." *Id*. The Ninth, Eleventh, Sixth, and Fifth Circuits have held similarly. *See In re NVIDIA Corp. Sec. Litig.*, 768 F.3d 1046, 1054, 1056 (9th Cir. 2014) ("Item 303 does not create a duty to disclose for purposes of Section 10(b) and Rule 10b-5."); *Carvelli v. Ocwen Fin. Corp.*, 934 F.3d 1307, 1331 (11th Cir. 2019) ("Item 303 imposes a more sweeping disclosure obligation than Rule 10b-5, such that a violation of the former does not ipso facto indicate a violation of the latter."); *In re Sofamor Danek Grp., Inc.*, 123 F.3d 394, 403 (6th Cir. 1997) (holding that plaintiffs argument "that defendants' disclosure duty under the Rule 10b–5 claim may stem from Item 303" was "unpersuasive"); *Mun. Emps.' Ret. Sys. of Mich. v. Pier 1 Imports, Inc.*, 935 F.3d 424, 436 (5th Cir. 2019) (stating that it "ha[s] never held that Item 303 creates a duty to disclose under the Securities Exchange Act.").

Impact: If the Supreme Court adopts the Second Circuit's approach, plaintiffs would be able to establish a duty to disclose under Section 10(b) and Rule 10b-5 when they otherwise may not be able to plead an omission case, potentially giving rise to significant enhanced liability for public companies' disclosures pursuant to Item 303.

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 as of February 5, 2024 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	Final rule adopted May 2023, effective July 31, 2023 Compliance for corporate issuers who file on domestic forms beginning with the first filing that covers the first full fiscal quarter that begins on or after October 1, 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 recent 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 until October 2023
SPACs	Comprehensive changes overhauling regulation of SPAC structure	Awaiting final action; pushed back until October 2023
Anticipated Rulemaking		
Corporate Board Diversity	Potential rulemaking requiring disclosure regarding diversity of board members and director nominees	Pushed back until April 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 until October 2023
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 until October 2023
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 until October 2023
Rule 144 Holding Period	Potential amendments to resale safe harbor for restricted / control securities	Pushed back 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, which was released by the U.S. Office of Information and Regulatory Affairs on June 13, 2023.

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