PAUL HASTINGS

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Public Company Watch

Key Issues Impacting Public Companies

Overview

This edition of the Public Company Watch highlights critical updates and regulatory changes affecting public companies. Staying informed on these topics is crucial for effective compliance and strategic planning.

Highlights include:

- **Regulation FD Enforcement Action:** A public company was charged with violating Regulation FD in the first enforcement action in which the SEC identified a non-intentional selective disclosure issue.
- **Nasdaq Board Diversity Rules Vacated:** Nasdaq-listed companies are no longer required to include board diversity metrics in public filings but may choose to retain certain disclosures on a voluntary basis.
- **Exchanges Propose Rules Limiting Use of Reverse Stock Splits:** Nasdaq and the NYSE have proposed rules that would limit a listed company's ability to utilize reverse stock splits to regain compliance with the applicable exchanges' minimum price criteria.
- **New HSR Rules Finalized:** Long-anticipated updates to the HSR were finalized, though it is likely their effective date will be pushed back by a regulatory freeze after President-elect Trump's inauguration.
- **New California Employment Laws:** Recently enacted legislation in California ushers in a new era of worker protections.
- **The Supreme Court Dismisses Cert:** The Supreme Court dismissed writs of certiorari in two cases against public companies after hearing oral arguments.

In This Edition

SEC Spotlight

SEC Charges DraftKings with Regulation FD Violation

On September 26, 2024, the SEC announced that it settled an enforcement action against DraftKings Inc. ("DraftKings"), a digital sports entertainment and gaming company that offers online sports betting, an online casino and daily fantasy sports. The SEC charged DraftKings with violating Regulation FD stemming from two social media posts made to the Chief Executive Officer's social media accounts, which contained material non-public information regarding the company's earnings. The social media posts were removed in short order, but the information contained therein was not publicly disseminated until multiple days later.

Regulation FD prohibits public companies, or those acting on their behalf, from selectively disclosing material non-public information to certain people external to the company, including market professionals and shareholders. Pursuant to Regulation FD, if a public company inadvertently shares material non-public information with a market professional or shareholder, then the company must "promptly" make the information public in a Regulation FD compliant manner such as by furnishing or filing a Current Report on Form 8-K (or Form 6-K in the case of foreign private issuers), issuing a press release or holding an adequately noticed conference call. Under Regulation FD, a disclosure is considered "prompt" if it is made "as soon as reasonably practicable (but in no event after the later of 24 hours or the commencement of the next day's trading on the New York Stock Exchange)" after a senior official becomes aware of the disclosure.

On July 27, 2023, during a quiet period between the company's quarter end and filing of its quarterly report on Form 10-Q, DraftKings' public relations firm posted information related to the company's second quarter performance to the Chief Executive Officer's personal X and LinkedIn accounts, each of which are followed by some DraftKings shareholders. The posts were not precleared by the company's communications team, as required by the DraftKings' Social Media Policy, and discussed financial and operational results during the company's quiet period, in violation of the DraftKings' Regulation FD Policy. Shortly after the postings were made, the communications team noted that the content should not have been shared and the posts were deleted. DraftKings did not subsequently release the content of the posts in a manner compliant with Regulation FD. Instead, general disclosure was made to the public on August 3, 2023, as part of the company's earnings materials and conference call.

The SEC found that DraftKings violated Regulation FD because it released material nonpublic information to some, but not all, of its shareholders, and upon realizing there had been a nonintentional selective disclosure, did not make the required prompt, public disclosure. The SEC also found that DraftKings violated Section 13(a) of the Securities Exchange Act of 1934 by virtue of its Regulation FD violation. As part of the settlement, DraftKings must pay a $200,000 fine and cease and desist from future violations of Regulation FD and Section 13(a). In addition, DraftKings agreed that all employees responsible for corporate communications will attend a Regulation FD training that also covers DraftKing's Regulation FD Policy.

This is the first time that the SEC has identified a non-intentional selective disclosure in an enforcement action. The bar for a company to make a non-intentional disclosure is high and the fact that the disclosure in this case was made by a third-party investor relations firm may explain why the SEC determined that it was a non-intentional release on the part of the company.

This settlement provides the following reminders for public companies:

- If a company makes a non-intentional selective disclosure of material nonpublic information, it must promptly disclose such information through a widespread communication channel that constitutes public disclosure for Regulation FD purposes.
- The SEC continues to focus on Regulation FD violations and companies should ensure that all employees are adequately trained as to their responsibilities under Regulation FD and the company's Regulation FD and Social Media Policies.
- Companies and their personnel should adhere to the company's policies and procedures, as the failure to do so provides the SEC with additional evidence to support an enforcement action.
- Companies should revisit their Regulation FD and Social Media Policies to ensure that they are up to date and reflect how the company communicates material information to the marketplace.
- To the extent that a company, its executives or others acting on its behalf use social media accounts to disclose material non-public information, the company needs to adhere to the requirements for such disclosures contained in the Netflix/Reed Hastings report the SEC issued on this topic in 2013.

Activism Updates

Delaware Chancery Court Limits Section 220 Demands

On October 24, 2024, the Delaware Chancery Court issued its opinion in *Roberta Ann K.W. Wong Leung Revocable Trust U/A Dated 03/09/2018 v. Amazon.com, Inc.*, in which it addressed the limits to Section 220 stockholder demands in a decision that will have significant implications for companies seeking to prevent stockholders from inspecting their books and records.

Section 220 of the Delaware General Corporation Law allows a company's stockholders to make a written demand to inspect the books and records of the company provided the stockholder has a "proper purpose" for the inspection. If the company refuses a Section 220 demand, the stockholder may apply to the Delaware Chancery Court for an order compelling the company to furnish its books and records.

Background: In *Roberta Ann K.W. Wong Leung Revocable Trust U/A Dated 03/09/2018 v. Amazon.com, Inc.*, the plaintiff, an Amazon stockholder, made a Section 220 demand to inspect Amazon's books and records for the purpose of investigating whether Amazon's fiduciaries had engaged in corporate mismanagement and wrongdoing by allowing the company to engage in anticompetitive practices resulting in regulatory complaints and fines. The demand followed an investigation and complaint by the Federal Trade Commission regarding potential anticompetitive conduct by Amazon. Amazon objected to the demand on the grounds that its stated scope and purpose were deficient. The plaintiff then applied to the Delaware Chancery Court to compel Amazon to furnish its books and records.

Outcome: The Court ruled that Amazon was not required to furnish its books and records because the plaintiff's stated purpose for the demand was too broad and was therefore not proper. In a Section 220 complaint, the burden is on the stockholder to show by a preponderance of the evidence that there is a proper purpose entitling them to inspect each item in the demand. The Court found that while investigating potential mismanagement or wrongdoing "has long been recognized as a proper purpose," the plaintiff failed to identify "*specific* and credible allegations sufficient to warrant a suspicion of …mismanagement." Because the plaintiff's demand covered *any* potential anticompetitive conduct by a large global company *anywhere* in the world at *any* time, the Court found that the purpose of the Section 220 demand was too broad in scope to determine the specific wrongdoing the plaintiff was seeking to investigate, noting that a stockholder's "[m]ere curiosity or a desire for a fishing expedition will not suffice."

Takeaways: The Court's decision significantly limits stockholders' rights to make a Section 220 demand and may have broad implications for companies seeking to prevent activists from investigating their books and records to gather information that can be used in an activist campaign. In its opinion, the Court noted, "Section 220 does not permit stockholders to act as inquisitors, searching a corporation's documents for any hint of transgression." Thus, stockholders will be required to articulate the purpose of a Section 220 demand with sufficient specificity in order to compel a company to furnish its books and records.

Other Updates

Fifth Circuit Vacated Nasdaq Board Diversity Rules

On December 11, 2024, the Court of Appeals for the Fifth Circuit issued a decision in *Alliance for Fair Board Recruitment v. SEC* vacating the SEC's approval of Nasdaq's board diversity rules. The rules required Nasdaq-listed companies to disclose the voluntary self-identified gender, racial characteristics and LGBTQ+ status of their board members and to have at least two directors who would be considered "diverse" or otherwise explain why they did not.

In *Alliance*, the court found that the SEC was unable to show that the Nasdaq diversity rules had a sufficient underlying connection to the purposes of the Securities Exchange Act of 1934, and held that the SEC therefore acted arbitrarily and capriciously and outside the bounds of its power when it approved the Nasdaq diversity rules.

As a result of the decision, Nasdaq-listed companies are no longer required to comply with the board diversity rules, but may choose to retain certain board diversity disclosure on a voluntary basis. In the meantime, the Fifth Circuit's narrow interpretation of the SEC's authority could have broader implications for SEC rulemaking.

For more information on the case, its implications and considerations on how to approach board diversity disclosure in your upcoming proxy statement, please see our **client alert**.

Nasdaq/NYSE Propose Rules Limiting Excessive Use of Reverse Stock Splits

Summary: Nasdaq and the NYSE have each proposed rules that could impact a public company's ability to utilize a reverse stock split as a mechanism to meet the relevant exchange's minimum price criteria, as well as the ability of companies who have utilized reverse stock splits in the recent past to stave off delisting procedures. The exchanges believe that engaging in frequent reverse stock splits is an ominous sign for the overall financial health of a company, suggestive that the company has serious underlying issues that, if not solved, will often lead to the company's longterm failure to meet the relevant exchange's continued listing standards—be it the minimum price criteria or otherwise. Accordingly, the exchanges believe that these companies are "inappropriate for trading on [the relevant exchange] for investor protection purposes" and, through the proposed rulemaking, seek to curtail the use of reverse stock splits as a tool for such companies to remain listed. Importantly, if a public company's stock price is likely to fall below $1.00, it should seek guidance early to understand the impact of these proposed rules as well as other recently adopted and proposed rules related to the delisting process.

Background: Both Nasdaq and the NYSE provide that listed companies must generally maintain a minimum bid price of $1.00. A Nasdaq-listed company would fall out of compliance if the company's stock price falls below $1.00 for 30 consecutive trading days. Each exchange sets forth procedures for a company that falls out of compliance with its minimum price criteria to regain compliance or otherwise be subject to delisting. Furthermore, Nasdaq's listing rules currently seek to curtail the excessive use of reverse stock splits by providing that if a company has effected one or more reverse stock splits over the preceding two-year period that have a ratio of 250 or more shares to one, taken cumulatively, such company cannot regain compliance with the minimum bid price rule by means of conducting another reverse stock split, but instead will receive a delisting determination. The NYSE rules do not currently limit a listed-company's ability to utilize reverse stock splits as a mechanism to regain compliance with the exchange's minimum price criteria.

The Proposed Rules: Among other things, Nasdaq's proposed rule limits the use of reverse stock splits even further, providing that if a company that effected a reverse stock split within the prior year falls out of compliance with the $1.00 minimum bid price requirement, that company will immediately receive a delisting determination. The company could still appeal to the Nasdaq Listing Qualifications Hearings Panel.

The proposed NYSE rule sets forth a similar regime for NYSE-listed companies. Pursuant to the proposed NYSE rule, if a company has effected a reverse stock split at any time during the prior year or has effected one or more reverse stock splits over the past two years with a cumulative ratio of 200 or more shares to one, then the company will no longer be eligible to utilize the compliance periods set forth in the rule, but rather the exchange will immediately conduct suspension and delisting procedures with respect to the subject security. The company would still be able to seek review of the delisting determination. The proposed rule also contemplates that an issuer would not be able to utilize a reverse stock split as a mechanism to regain compliance with the minimum bid price requirement if doing so would result in the security no longer meeting the continued listing requirements in Section 802.01A of the NYSE rules.

The proposed rules remain subject to SEC review and are not yet effective.

Key Takeaways: Listed companies that effect a reverse stock split to cure non-compliance with the relevant exchange's minimum price criteria should carefully consider the appropriate ratio to utilize in order to provide the company sufficient runway to remedy the financial and/or operational issues underlying the company's low stock price.

Finalized Hart-Scott Rodino Rules Released

On October 10, 2024, the FTC voted 5–0 to adopt new rules under the HSR Act. While these new rules are scaled-back versions of the rules originally proposed on June 27, 2023, they still significantly change the amount of information and number of documents required to be produced with the initial filing for both deals with competitive concerns and those without. This will make HSR filings more burdensome and significantly more expensive for both buyers and sellers.

What Will and Will Not Change: The new rules do not alter the statutory mandates for the size and types of transactions that must be reported. Instead, the new rules alter the form itself, requiring up front the type of information that is commonly asked for during preliminary investigations and second requests.

For example, filers will be required to describe the actual and potential competitive overlaps and vertical relationships. They will also be required to disclose:

- Foreign Subsidy Information: Any subsidy (or commitment to receive a future subsidy) from any foreign entity of concern or covered nation government (as defined in the Infrastructure Investment and Jobs Act).
- Orbit Information: Information on certain investors, including limited partners that also have management rights related to the board, and organizational charts for funds and master limited partnerships (for the buyer, if they exist).
- Item 4/Ordinary Course Documents: Additional transaction documents from the supervisor of each filing party's deal team and certain ordinary course documents, including documents already translated from foreign languages.

In addition, the FTC is introducing a new online portal for comments to be submitted on proposed transactions that may be under review. According to the FTC, they welcome "information on specific transactions and how they may affect competition from consumers, workers, suppliers, rivals, business partners, advocacy organizations, professional and trade associations, local, state, and federal elected officials, academics, and others."

What Happens Next: The current rules are scheduled to go into effect February 10, 2025. However, this timeline may be pushed back by a regulatory freeze. Former Presidents Obama, Trump and Biden all issued freezes on federal regulations that had not yet gone into effect. As he did in 2017, President-elect Trump may issue a similar freeze following his inauguration on January 20, 2025.

What to Do Now: Now that the rules have been finalized public companies should take the following steps to prepare for future antitrust filings:

- Officers, directors, deal leads and the employees that create documents for them should receive immediate antitrust training. They need to be aware of how their wording can impact reviews of transactions given the expanded document collection, including drafts sent to any member of the board.
- Companies considering a transaction should discuss the competitive landscape with antitrust counsel and plan for customer outreach now that the FTC and DOJ will have customer names as soon as a filing is made.

- Frequent filers should consider how they can save time and money by collecting certain required information annually.
- Parties in negotiations may need to rethink the deal timeline, especially the number of business days to get on file for those who have not prepared for the implementation of these new rules.

For additional information, please see our **article**.

California Ushers in a New Wave of Employment Laws

Signing off on a busy legislative year, Governor Newsom just confirmed into law over a dozen bills from the California Legislature. As a result, many California employees will begin next year with new and enhanced rights related to wages, discrimination, retaliation, leave and workplace disclosures, among others. Generally, these new laws will be effective January 1, 2025. As 2024 draws to a close, public companies with employees in California should review their policies for compliance with these laws. For an in depth exploration of the new rules, please see our **client alert**.

Litigation Update

Federal Court Vacates DOL's Final Overtime Rule Nationwide

The Fair Labor Standard Act ("FLSA") generally requires an employer to pay an employee timeand-a-half ("overtime") if the employee works more than 40 hours in a week. But the FLSA exempts certain employees from that requirement, notably, certain executive, administrative and professional ("EAP") workers under the so-called "white-collar exemption." To properly classify an employee as "exempt" under the white-collar exemption, the employee generally must be: (1) paid on a salary basis ("salary basis test"), (2) perform specific exempt duties ("duties test"), and (3) earn a minimum salary ("salary level test").

In April 2024, the U.S. Department of Labor ("DOL") issued a Final Rule increasing the weekly salary threshold for the exemption for EAP employees in two phases. Under the Final Rule, the weekly exempt salary minimum increased from $684 per week ($35,568 per year) to $844 per week ($43,888 per year) on July 1, 2024, and was set to increase to $1,128 per week ($58,656 per year) on January 1, 2025, with updates scheduled for every three years. The Final Rule also increased the minimum salary level for "highly-compensated employees" from $107,432 to $132,964 as of July 1, 2024, and again to $151,164 as of January 1, 2025, also with automatic increases to the threshold every three years.

On November 15, 2024, the U.S. District Court for the Eastern District of Texas invalidated the DOL's 2024 Final Rule, finding that the DOL exceeded its statutory authority by issuing the Final Rule. The decision vacates the rule nationwide, halting its implementation and restoring the salary level in effect prior to July 1, 2024.

The DOL may seek to appeal the court's decision to the Fifth Circuit Court of Appeals, but such an appeal is not likely with the upcoming change in the presidential administration.

Update: The Supreme Court Dismisses Cert on Two Recent Cases

In the **July 2024 edition** of the *Public Company Watch*, we reported on the Supreme Court's grant of two petitions for certiorari concerning issues in private securities fraud actions.

As a reminder, on June 10, 2024, the Supreme Court granted a petition for certiorari in *Facebook, Inc. v. Amalgamated Bank*, No. 23-980. That petition raised the question of whether "risk disclosures [are] false or misleading when they do not disclose that a risk has materialized in the past, even if that past event presents no known risk of ongoing or future business harm." The appeal arose out of a private securities-fraud class action filed against Facebook (now Meta) relating to Cambridge Analytica's misuse of Facebook user data. Plaintiffs alleged that certain statements in Facebook's discussion of "risk factors" in its 2016 Form 10-K filing warning of potential security breaches were false or misleading because they did not mention the prior disclosure of user data to Cambridge Analytica. The district court had dismissed plaintiffs' claims but a divided panel of the Ninth Circuit had reversed the district court's dismissal in part, holding that Facebook's disclosures "represented the risk of improper access to or disclosure of Facebook user data as purely hypothetical when that exact risk had already transpired."

On June 17, 2024, the Supreme Court granted a petition for certiorari in *NVIDIA Corp. v. E. Ohman J:or Fonder AB*, No. 23-970. That petition raised two questions relating to the pleading standards for securities fraud class actions under the Private Securities Litigation Reform Act of 1995 ("PSLRA"). The first question was "[w]hether plaintiffs seeking to allege scienter under the PSLRA based on allegations about internal company documents must plead with particularity the contents of those documents." The second question was "[w]hether plaintiffs can satisfy the PSLRA's falsity requirement by relying on an expert opinion to substitute for particularized allegations of fact." The appeal arose out of a private securities fraud class action filed against NVIDIA and its CEO relating to revenue disclosures for NVIDIA's graphics processing units ("GPUs"). On the first question, the Ninth Circuit allowed the plaintiffs to proceed past a motion to dismiss based on allegations speculating as to what certain internal company documents might have said about GPU sales and usage data. On the second question, the Ninth Circuit's decision relied directly on plaintiffs' expert opinion in determining the question of whether defendant's statements were adequately alleged to be false.

In a surprising development, after hearing oral argument on both cases, the Supreme Court issued *per curiam* orders dismissing the writs of certiorari in both cases as "improvidently granted," indicating that the Court determined that it should not have taken up either case. (The order on the *Facebook* case was issued on November 22, 2024, and the order on the *NVIDIA* case was issued on December 11, 2024.) The Court did not provide its reasoning for the decisions in either of the orders, even though briefing of the appeals had concluded and oral argument had been held in both cases. As a result, both cases will likely be returned to the district courts for proceedings consistent with the Ninth Circuit's decisions.

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About Paul Hastings

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