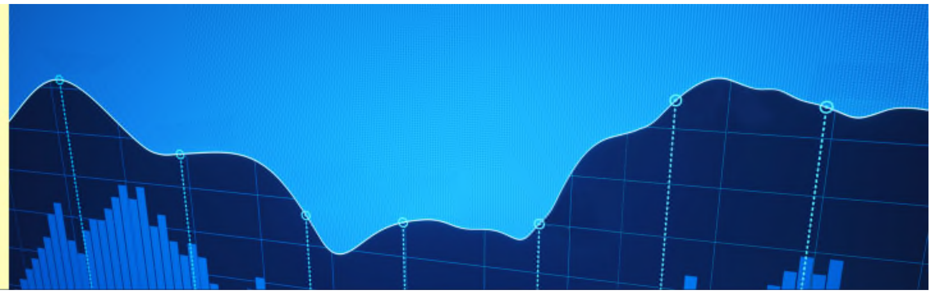

Securities Quarterly Update

April 2023 | Spring Edition

Welcome to the spring edition of Securities Quarterly Update*, a publication that provides updates and guidance on securities regulatory and compliance issues. In this edition, we look at recent developments impacting disclosure controls and procedures, insider filings, and quarterly and other SEC reports.*

Recent Bank Failures

Recent bank failures are causing some companies to revisit – at the board level – their cash management practices and liquidity sources. Any material trends arising from the bank failure fallout and related disruption, whether impacting the company directly or indirectly through its customers and suppliers, may need to be discussed in the MD&A and risk factors in quarterly and annual reports. Companies in the banking industry may need to distinguish their business models and, in some cases, explain risk mitigation strategies in greater detail. Additional regulation may also be implemented.

SEC Amendments to Rule 10b5-1 Trading Plans Effective as of February 27, 2023

New Conditions for Rule 10b5-1 Trading Plans

In December 2022, the SEC adopted amendments to Rule 10b5-1, including changes to the availability of the affirmative defense to insider trading. The new conditions include:

- **Cooling-Off Periods for Directors and Officers:** Trading cannot begin until the later of (1) 90 days following plan adoption or modification or (2) two business days following the disclosure in certain periodic reports of the company's financial results for the fiscal quarter in which the plan was adopted or modified (but not to exceed 120 days following plan adoption or modification).
- **Cooling-Off Period for Persons Other Than Directors and Officers:** A cooling-off period of 30 days applies before trading can begin.
- **Director and Officer Representation:** Directors and officers are required to include a representation in their Rule 10b5-1 plan certifying that at the time of the adoption of a new or modified plan (1) they are not aware of any material nonpublic information about the company or its securities and (2) they are adopting the plan in good faith.
- **Prohibition on Overlapping Plans:** A person, other than the company, cannot use multiple, overlapping Rule 10b5-1 Plans.
- **Restrictions on Single-Trade Plans:** A person, other than the company, cannot have more than one single-trade Rule 10b5-1 plan during any 12-month period.
- **Good Faith:** All persons entering a Rule 10b5-1 plan are required to act in good faith with respect to that plan.

Insider trading policies and procedures should be amended, as needed, to incorporate these changes and the changes to Section 16 beneficial ownership reporting described below.

Forms 4

Updated Reporting for Gifts

The SEC's amendments require Section 16 reporting persons to report bona fide gifts of securities on Form 4, rather than Form 5, within two business days.

New Checkbox

Forms 4 and 5 now include a checkbox where insiders are required to indicate whether a reported transaction was made pursuant to a Rule 10b5-1 plan and to indicate the date of the adoption of the Rule 10b5-1 plan in the explanation of responses portion of the Form 4.

Forms 144

Electronic Filing of Form 144 Now Required

In June 2022, the SEC adopted amendments that require certain Forms 144 to be filed electronically on EDGAR, rather than submitted in paper form as was previously permitted. The requirement applies to Forms 144 related to the sale of securities of public companies subject to the reporting requirements under Section 13 or 15(d) of the Exchange Act. The compliance deadline is April 13, 2023.

Note that the company's administrators and brokerage firms may need information and insiders' signed consents in advance in order to implement these changes.

EDGAR Filing Deadline for Form 144 Extended

On February 21, 2023, the SEC issued a release which amended Regulation S-T to extend the filing deadline for Forms 144 filed electronically from 5:30 p.m. to 10 p.m. ET, which now corresponds with the 10 p.m. ET filing deadline for Forms 3/4/5. The new filing deadline went into effect on March 20, 2023.

Recent SEC Enforcement Actions

Companies and their disclosure committees should note the following recent SEC enforcement actions and revisit their disclosure controls and procedures as needed.

SEC Announces Settlement for Failure to Maintain Disclosure Controls Related to Employee Complaints of Workplace Misconduct

The SEC recently announced that a public company agreed to pay $35 million to settle allegations that it failed to maintain disclosure controls and procedures to collect and review employee complaints of workplace misconduct. The SEC found that the lack of controls meant that company management was "unable to assess related risks to the company's business, whether material issues existed that warranted disclosure to investors, or whether the disclosures it made to investors in connection with these risks were fulsome and accurate."

The company included a customary risk factor about recruiting and retaining personnel, from which the SEC inferred that controls and procedures were necessary for ensuring that any relevant information, such as that related to employee complaints of workplace misconduct, were collected and analyzed for disclosure purposes. This action is particularly significant as the SEC did not allege that the existing disclosure was misleading.

SEC Announces First Insider Trading Action Based on Rule 10b5-1 Plans

The SEC has charged the chief executive officer of a healthcare company with insider trading for allegedly engaging in an insider trading scheme using Rule 10b5-1 plans. According to the complaint, the insider established two Rule 10b5-1 trading plans while in possession of material, nonpublic information relating to negative developments with the company's largest customer. The SEC's complaint charges the insider with violating antifraud provisions of the federal securities laws and seeks permanent injunctive relief, disgorgement of ill-gotten gains with prejudgment interest, civil penalties, and an officer and director bar for the insider. The Department of Justice has also charged the insider.

SEC Charges Another Company with Earnings Management

The SEC recently announced settled charges against another public company for allegedly manipulating its financial reports to meet earnings guidance and analyst estimates. The company allegedly (i) improperly deferred, and spread over multiple quarters, incurred expenses to minimize their impact on net earnings; (ii) did not properly write down assets and uncollectable receivables; and (iii) manipulated earnout liabilities related to the company's acquisitions to create an income "cushion" to offset expenses. The company agreed to pay millions in disgorgement and prejudgment interest (satisfied by a prior class action settlement).

SEC Charges IT Service Provider for Allegedly Misleading Non-GAAP Disclosures

On March 14, the SEC charged an IT services company with allegedly making misleading disclosures about its non-GAAP financial performance. According to the SEC, the company increased its reported non-GAAP net income by allegedly misclassifying millions of dollars of expenses as non-GAAP adjustments for transaction, separation, and integration-related (TSI) costs and excluding them from its non-GAAP earnings. The SEC found that the company's disclosure controls and procedures failed to ensure that its expense classifications were consistent with its public description of TSI costs. The company agreed to comply with a cease-and-desist order, pay an $8 million fine, and develop and implement appropriate non-GAAP policies and disclosure controls and procedures.

Companies should confirm their controls and procedures and assess if any additional policies are needed for non-GAAP financial measures, if such measures are used.

Company Settles SEC ESG Disclosure Charges

In an action arising from the activities of the Climate and ESG Task Force in the SEC's Division of Enforcement, the SEC recently charged a mining company with making false and misleading claims about the safety of its dams. One of the company's dams collapsed, resulting in fatalities. The company lost more than $4 billion in market capitalization.

According to the complaint, the company allegedly altered multiple dam safety audits, obtained fraudulent stability certificates, and regularly misled local authorities and communities about the safety of the dam through its ESG disclosures. The complaint also alleged that the company knew the dam did not meet internationally recognized dam safety standards, but stated in its ESG reports that the company adhered to the "strictest international practices" in evaluating dam safety and that all its dams were certified as stable.

The SEC's complaint charged the company with violating antifraud and reporting provisions of federal securities laws and sought injunctive relief, disgorgement plus prejudgment interest, and civil penalties. The company recently agreed to pay more than $55 million to settle the charges. Per Associate Director of the SEC's Division of Enforcement, "the terms of today's settlement … will … demonstrate that public companies can and should be held accountable for material misrepresentations in their ESG-related disclosures, just as they would for any other material misrepresentations."

Section 16 Litigation

Family Member's Purchase of Stock Potentially Matchable with Insider's Sale of Stock

A California court denied a motion for summary judgment in a Section 16(b) action alleging that an insider's stock sale was matchable to the purchase by his adult child residing outside of his home. Section 16(b) requires strict disgorgement of "short swing" profits (i.e., within six months of non-exempt opposite way transactions) from insider transactions in public companies' shares.

The alleged purchase involved the adult child's acquisition of stock from another family member. Under these facts, the insider, the chief executive officer of an OTC-quoted company, reported his adult child's stock acquisition as a purchase and showed stock ownership indirectly through his adult child. Three months later, the insider sold certain directly owned shares, but the Form 4 reporting the sale did not show the adult child's holdings. The court found that there were questions of fact relating to whether the adult child's action was a purchase and as to beneficial ownership. There may also be questions as to the child's financial independence. The litigation is ongoing and worth keeping an eye on given potential implications to trading by family members.

Clayton Act Director Interlocks

Directorships at Competitors

Regulatory activity relating to director interlocks continues outside of the M&A context, resulting in some resignations. In light of congressional and regulatory interest, companies should confirm that there are no interlocking directorships under the Clayton Act.

FOR MORE INFORMATION

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