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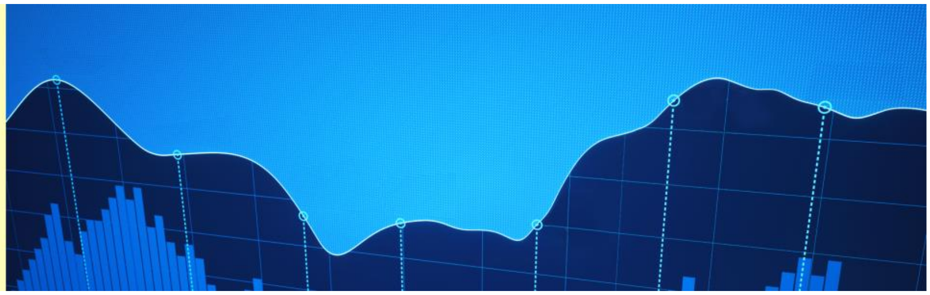

Securities Quarterly Update

October 2024 | Fall Edition

Welcome to the fall edition of Securities Quarterly Update*, a publication that provides updates and guidance on securities regulatory and compliance issues. In this edition, we review certain recent SEC developments and enforcement actions, select SEC comment letters, as well as some considerations for quarterly and annual reports on Forms 10-Q and 10-K.*

Form 10-Q/10-K Considerations

Inflation and Interest Rates

On September 18, 2024, the Federal Reserve cut interest rates for the first time in four years and indicated that future cuts may be coming in 2024 and 2025. Companies should consider how these cuts might impact their Business, Management's Discussion and Analysis (MD&A) and Risk Factor sections and whether any updates are necessary.

***Chevron* and Other Administrative Law Decisions**

In June 2024, the Supreme Court overruled *Chevron v. Natural Resources Defense Council*, a significant ruling that required courts to defer to reasonable agency interpretations of the law when Congress did not clearly address an issue. Companies in regulated industries should review their Risk Factors, MD&A and regulatory sections and consider whether any updates are necessary.

Information Technology Outages

Following the CrowdStrike outage, companies should consider if any updates are needed, particularly to the Risk Factors and Cybersecurity sections regarding system outages or reliance on third-party technology, and revise any hypothetical language included in those Risk Factors.

Artificial Intelligence

Companies are increasingly including discussion of artificial intelligence (AI) in their SEC filings, particularly in Risk Factors. Some are including new, stand-alone AI-related risk factors, while others are adding AI disclosure to existing risk factors, such as cybersecurity, operations, or reputation risk factors. Discussion of AI is also increasingly included in their Business and MD&A sections of Form 10-K/10-Q filings. When considering if any such updates are needed, companies should remain mindful of the SEC's admonitions regarding AI-washing.

Natural Disasters

Companies should consider the impact that natural disasters and severe weather events, such as Hurricane Helene, may have on their businesses. If the impact is significant, companies should consider if additional disclosures are necessary in their MD&A and Risk Factor sections.

U.S. Presidential Election

Companies should consider how global political conditions, particularly the November U.S. presidential election, might impact their businesses, including any potentially significant impact on their supply chains, and whether any updates to their Business section, MD&A or Forward-Looking Statements are necessary.

Form 10-K Reminder – Insider Trading Policy

As a reminder, companies are required to file an insider trading policy as Exhibit 19 to an upcoming Form 10-K. They will also be required to disclose annually whether the company has an insider trading policy, and if not, explain why. Consider if any updates to such policies and guidelines are needed, particularly given the SEC's recent regulatory and enforcement activity.

SEC Filings – EDGAR Updates

Updates to Filing Fee Exhibits

As of July 31, 2024, large accelerated filers are required to tag filing fee exhibits for certain filings in Inline XBRL (iXBRL) format. Impacted filings include registration statements on Forms S-1, S-3, S-4 and S-8, among others. All other filers are required to comply with the iXBRL tagging requirements beginning July 31, 2025. Companies should plan for some extra processing time and note that the fee exhibit requires some technical changes to accommodate iXBRL tagging.

SEC Fee Rate Increase

The SEC's fee rate has increased from $147.60 per $1 million to $153.10 per $1 million, effective October 1, 2024. For more information, see the SEC's announcement.

SEC Adopts Amendments to Enhance EDGAR Security

On September 27, 2024, the SEC adopted amendments (collectively referred to as "EDGAR Next") intended to enhance the security of EDGAR. EDGAR filers will be required to authorize individuals who will be responsible for managing their accounts, and these individuals will need individual account credentials from Login.gov to access EDGAR accounts and make filings. Each individual filer will be required authorize at least one individual as an account administrator (which could be the individual themself) who will manage the filer's account, confirm annually that all individuals and entities on a filer's EDGAR dashboard are authorized to act on behalf of the filer, and maintain accurate and current information on EDGAR. Companies (other than single-member companies) will need to authorize at least two account administrators.

The SEC is also updating Form ID. Among other new requirements, applicants for EDGAR access will be required to (i) designate on Form ID the specific individual(s) who have been authorized to act as administrators for their EDGAR accounts, (ii) provide a Legal Entity Identifier (if applicable), (iii) provide more specific personal and contact information for the filer and other authorized individuals, and (iv) disclose if the applicant, the account administrator(s) or the individual signing the Form ID has been convicted of or civilly or administratively enjoined, barred, suspended or banned as a result of a federal or state securities violation. Forms ID will still need to be notarized. For non-affiliated account administrators, notarized powers of attorney will also be needed.

Compliance with these new requirements will require significant preparation. Companies should consider necessary process changes and how they will obtain required representations.

Applicants for EDGAR access will be required to comply with the amended Form ID beginning March 24, 2025. Beginning September 15, 2025, compliance with EDGAR Next will be required to file.

SEC Releases Spring 2024 Reg-Flex Agenda

In July 2024, the SEC released its Spring 2024 Regulatory Agenda (Reg-Flex Agenda). While the Reg-Flex Agenda is not binding, it provides some indication of when the SEC may propose or finalize various rules. The items listed in the current agenda "reflect only the priorities of [Chair Gary Gensler], and do not necessarily reflect the views and priorities of any individual Commissioner." Among other rules, October 2024 is listed as a target date for issuing proposed rules relating to human capital management disclosure and incentive-based compensation arrangements for certain financial services companies. The SEC has deferred finalizing or proposing a number of other rules to April 2025, including corporate board diversity, disclosure of payments by resource extraction issuers, Rule 144 holding period, Regulation D and Form D improvements, and revisions to the definition of securities held of record.

ESG Update – California Climate Disclosure Law Signed

In July 2024, California Governor Gavin Newson proposed amendments to two major California climate bills (S.B. 253 and S.B. 261, previously signed by Governor Newsom in October 2023) that would have delayed initial reporting deadlines by two years. However, the proposals failed to pass during California's recently concluded legislative session. Instead, the legislature passed S.B. 219, which makes minor changes to the Climate Corporate Accountability Act (S.B. 253) and the Climate-Related Financial Risk Act (S.B. 261), including delaying the deadline for the California Air Resources Board (CARB) to issue regulations establishing greenhouse gas emissions reporting requirements to July 1, 2025, and consolidating reporting requirements at the parent level for entities subject to S.B. 253. Covered companies are required to report Scope 1 and

2 emissions beginning in 2026 (or by a date to be determined by CARB) and Scope 3 emissions beginning in 2027. On September 27, 2024, Governor Newson signed S.B. 219 into law. Litigation related to the California climate rules is ongoing.

Litigation related to the SEC's climate-related disclosure is still pending, and it has been reported that the SEC's ESG enforcement task force was disbanded. However, enforcement actions and greenwashing and similar ESG-related litigation are likely to continue. For example, see "ESG Disclosures" under "SEC Enforcement Actions" below.

Recent Changes in Delaware

Delaware Approves Market Practice Amendments

On August 1, 2024, an extensive set of amendments to the Delaware General Corporation Law became effective. These amendments are intended to address several recent Delaware Court of Chancery decisions that were thought to be inconsistent with established market practice. Among other things, the amendments provide that (i) companies can enter into stockholder agreements that grant certain governance rights to stockholders, (ii) companies can approve a merger agreement in "substantially final form," and (iii) parties to a merger agreement may provide for penalties or consequences for a breach of the merger agreement.

Delaware Clarifies the Standard of Review for Challenges to Advance Notice Bylaws

In July 2024, the Delaware Supreme Court released its decision in *Kellner v. AIM Immunotech Inc.*, which clarifies how Delaware courts will determine the validity and enforceability of advance notice bylaws. The decision stemmed from a years-long proxy battle at AIM Immunotech.

The case was appealed to the Delaware Supreme Court, which held there are two standards of review that can apply to an advance notice bylaw challenge, depending on whether the challenge is facial or as applied. In a facial challenge, advance notice bylaws are presumed to be valid, and plaintiffs must show that the bylaw "cannot operate lawfully under any set of circumstances." If there is an ongoing proxy contest, the standard of review changes and the advance notice bylaws are subject to an enhanced scrutiny standard, where courts must determine whether the board "faced a threat to an important corporate interest or to the achievement of a significant corporate benefit. The threat must be real and not pretextual, and the board's motivations must be proper and not selfish or disloyal." Courts must also determine "whether the board's response to the threat was reasonable in relation to the threat posed and was not preclusive or coercive to the stockholder franchise." In response to this decision and other Delaware and SEC developments, companies should consider reviewing their bylaws, if not recently updated.

Beneficial Ownership Reporting – Corporate Transparency Act

Deadlines for compliance with the Corporate Transparency Act (CTA) are quickly approaching, with companies formed before January 1, 2024, required to file with FinCEN by December 31, 2024, and newly formed entities already subject to filing obligations. Although SEC-reporting companies are exempt from the filing requirements, public companies should review joint ventures and other non-controlled entities, as filings for those entities may be required. Companies should also consider which procedures and controls for CTA compliance they should implement.

Accelerated Schedule 13D/13G Filing Deadlines

As a reminder, in October 2023, the SEC adopted amendments to the beneficial ownership rules under Sections 13(d) and (g) of the Securities and Exchange Act of 1934 (the "Exchange Act"), including rules that shortened the filing deadlines for initial beneficial ownership reports and amendments filed on Schedule 13D/13G. Compliance with the shortened Schedule 13G filing deadlines for both initial filings and amendments is required as of September 30, 2024. As an example, instead of annual amendments, some Schedule 13G amendments are now required within 45 days after the quarter end. Shortened filing deadlines for Schedules 13D and amendments are currently also in effect.

Recent SEC comment letters (examples here and here) further indicate that SEC staff is more closely monitoring the timeliness of reports filed on Schedule 13D, and it is likely that SEC staff will continue to issue similar comment letters.

Cash Flow Classification

As discussed in our Winter 2024 *Securities Quarterly Update*, SEC Chief Accountant Paul Munter reminded companies and their auditors that the statement of cash flows "has consistently been a leading area of restatements." The SEC recently sent comment letters to companies asking them to explain certain statement of cash flow disclosures, such as the classification of insurance proceeds and the classification of activities related to loans, net of allowance for credit losses. In light of this increased scrutiny, public companies may want to revisit their disclosures of any significant accounting policies that materially affect the determination of cash flow classification and review their internal controls related to cash flow classification.

SEC Enforcement Actions

Regulation FD (Selective Disclosures)

In September 2024, the SEC charged a company for allegedly disclosing certain material, nonpublic information through the company CEO's personal social media accounts without disclosing the same information to all investors. In 2023, posts were published on the CEO's personal X and LinkedIn accounts asserting that the company continued to see "really strong growth" in certain states. The posts were made before the company disclosed its second quarter 2023 financial results. To comply with Regulation FD, companies are required to promptly disclose the information to all investors after it is disclosed to those who viewed the social media posts. Here, the company allegedly did not disclose the information to the public until seven days later when it announced its second quarter earnings. The company agreed to cease and desist from violating the charged provisions, pay a civil penalty, and comply with certain undertakings, such as providing Regulation FD training for relevant employees.

Companies may want to review their Regulation FD policies, social media guidelines and related training materials.

Revenue-Related Disclosures

In August 2024, the SEC announced settled charges against a company, its former CEO, its former CFO and its current CEO for allegedly misleading the public about the company's financial performance. Among many other allegations, the SEC alleged that the company and its former CEO reported specific revenue guidance, despite several factors indicating that the company would not meet that guidance. The company and its former CEO allegedly also provided to their auditors inaccurate management representation and an inaccurate letter relating to an asset purchase. Additionally, the former CEO allegedly did not disclose his personal interest in two companies that were doing business with the company. The SEC alleged that the parties violated antifraud, reporting, internal control, and books and records provisions of the federal securities laws. The parties agreed to cease and desist from future violations and paid penalties. The former CEO also agreed to pay disgorgement and prejudgment interest and received a 10-year officer and director bar.

The SEC also announced charges against a company that allegedly manipulated its cost estimates to meet certain budget projections, resulting in an allegedly improper revenue recognition. The company allegedly prematurely recognized revenue and therefore met or exceeded analyst expectations for earnings before interest and tax. The company and its parent company agreed to permanent injunctions and the company paid a large fine. The officers involved have been charged with accounting fraud; litigation is pending.

If not already part of their training programs, companies may want to consider including related reminders and revisiting related controls.

Potential Market Size Disclosures

In September 2024, the SEC announced settled charges against a company for allegedly misleading initial public offering investors about the market potential, revenue prospects and customer pipeline for its products. The SEC alleged that the company based its market potential on flawed and unreasonable assumptions, partially as a result of poor communication between internal teams. Specifically, the finance team allegedly used inaccurate assumptions regarding pricing and target markets that were inconsistent with other internal sales analyses. The SEC also argued that the company provided research analysts with revenue projections, inflated by both the finance and sales teams, that were materially misleading. The company agreed to a cease-and-desist order and paid a civil penalty.

Companies should pay careful attention to any disclosures relating to the potential market for their products or services, related back-up, and related board and internal communications.

Beneficial Ownership Reports on Schedules 13D and G and Forms 3, 4, 5 and 13F

As a result of yet another SEC enforcement sweep in this area, in September 2024, the SEC settled charges against approximately two dozen entities and individuals for allegedly failing to timely report transactions and holdings on Schedules 13D and 13G and Forms 3, 4, 5 and 13F. The settlements involve two public companies charged "for contributing to filing failures by their officers and directors and failing to report their insiders' filing delinquencies as required."

For companies, in addition to untimely 10-K/proxy disclosures of late Forms 4, the SEC states that "[a]lthough the Commission encourages the practice of many issuers to assist insiders in complying with Section 16(a) filing requirements, issuers who voluntarily accept certain responsibilities and then act negligently in the performance of those tasks may be liable as a cause of Section 16(a) violations by insiders [such as by not having sufficient controls to file Forms 4 within the required two business days]." The SEC also states that "insiders remain responsible for the timeliness and accuracy of their required Section 16(a) reports."

All entities and individuals agreed to stop violating the relevant provisions and pay civil penalties totaling $3.8 million. "[These] actions are a reminder to large investors that they must commit necessary resources to ensure these reports are filed on time," said Thomas P. Smith, Associate Regional Director of the SEC's Division of Enforcement.

Companies should consider if a training refresher is needed and if it is clear when the company did and did not assume responsibility for these filings.

SEC Whistleblower Protection Rules – Confidentiality, Monetary Award and Similar Provisions in Separation Agreements and Other Documents

In September 2024, the SEC announced yet another set of settled charges against seven public companies for employment, separation and other agreements that could allegedly prevent whistleblowers from reporting potential misconduct to the SEC, a violation of whistleblower protection Rule 21F-17(a). Among other alleged issues, "these companies required employees to waive their right to possible whistleblower monetary awards. This severely impedes would-be whistleblowers from reporting potential securities law violations to the SEC," said Jason J. Burt, Director of the SEC's Denver Regional Office. The companies paid around $3 million in civil penalties and agreed to take action to rectify the violations, including making changes to the relevant agreements.

Companies should consider if their employment, separation and similar agreements, codes of ethics and conduct, employee handbooks and similar policies have been recently reviewed to address SEC, Department of Labor and other developments.

Proxy Statement Disclosures – Director Independence

In September 2024, the SEC announced settled charges against the former CEO, chairman and, subsequently, an independent board member of a company for violating proxy disclosure rules by failing to disclose a personal relationship with a high-ranking company executive, allegedly leading to materially misleading statements about his independence in the company's proxy statements. Among other alleged issues, the director vacationed with the executive, paid substantial travel expenses for the executive, encouraged the executive to conceal their relationship, and shared confidential details about the CEO succession process with the executive.

The SEC noted that when making director independence determinations, the board relied on the director to disclose any relevant information. For example, the company's director and officer (D&O) questionnaire included examples of "material relationships." Although the D&O questionnaire did not list friendships, it asked if directors had "any other relationship" with the company or its executives, to which the director responded "no." The director also did not comment on his independence determination in the company's proxy statements when reviewing drafts. Once the company discovered the relationship, the company determined that the director was not independent.

The director agreed to be permanently enjoined from further violations of the proxy provisions of the Exchange Act, pay a civil penalty, and be subject to a five-year director and officer bar.

Companies should review their D&O questionnaires to confirm if such relationships would be covered and to consider if additional instructions for completing such questionnaires would be helpful to their directors.

ESG Disclosures

In September 2024, the SEC charged a company for allegedly making inaccurate statements in its annual reports regarding the recyclability of its products. The SEC alleged that the company asserted that its recycling facilities believed their products were recyclable, but failed to disclose that those recycling facilities had instead expressed concern regarding the recyclability of the products and were unwilling to accept them. "When a company speaks to an issue in its annual report, they are required to provide information necessary for investors to get the full picture on that issue so that investors can make educated investment decisions," said John T. Dugan, Associate Director of the Boston Regional Office. The company agreed to a cease-and-desist order and paid a civil penalty.

Companies should look out for greenwashing, AI washing and related claims in their SEC filings and in ESG reports, company websites, press releases, marketing materials and other disclosures.

FOR MORE INFORMATION

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Previous Editions of Securities Quarterly Update

- Q3 | Summer 2024
- Q2 | Spring 2024
- Q1 | Winter 2024
- Q4 | Fall 2023