PUBLIC COMPANY UPDATE AND OTHER TRENDING TOPICS

January 22, 2025

01

SEC Rules Update

Covering a variety of issues of recent rulemaking and thoughts for 2025

Your Speakers

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Discussion Road Map

1. Insider Trading Policies
2. Option Grant Practices
3. Cybersecurity Rules Guidance
4. Risk Factor Updates
5. Climate Rules Update
6. Others

Annual Insider Trading Policy Exhibit Filing and Disclosures

Beginning in 2025, companies must:

- **Disclose whether** or not (and if not, why not) the **company has adopted insider trading policies** and procedures
- **File their insider trading policies** and procedures as an exhibit to the 10-K.

Considerations for Insider Trading Policies:

- Consider whether any adjustments would be appropriate in anticipation of their public visibility
- Address new Rule 10b5-1 Plan requirements (if plans are addressed in policies with any specificity):
  - Key 10b5-1 plan changes: Cooling-off periods (90 or 120 days); heightened certifications requirement; overlapping plans not eligible for safe harbor (with some exceptions); single-trade arrangements or "bullet plans" – limited to one per 12 months; good faith requirement extended – "acted in good faith"
  - Applies to amendments, terminations
  - More focus on gifts: "[A] donor of securities violates Section 10(b) if the donor gifts a security of an issuer in fraudulent breach of a duty of trust and confidence when the donor was aware of material nonpublic information about the security or issuer, and knew or was reckless in not knowing that the donee would sell the securities prior to the disclosure of such information. The affirmative defense under Rule 10b5-1(c)(1) is available for planned securities gifts."
- Review policies in light of DOJ shadow trading prosecutions (e.g., trading in competitors shares)

New Option Grant Policy and Practices Disclosure

Annual disclosure of option grant policies and new tabular disclosure *(new Item 402(x) of Reg. S-K)*

Disclose grant polices/practices for options & SARs regarding (1) timing of grants and release of MNPI and (2) how issuer considers MNPI

- The new rules require narrative disclosure about an issuer's grant policies and practices for options and option-like instruments (such as SARs and similar instruments) regarding the timing of grants and the release of material nonpublic information, including how the board determines when to grant options and whether, and if so, how, the board or compensation committee takes material nonpublic information into account when determining the timing and terms of an award.

Tabular disclosure of certain grants

- If in last fiscal year, an issuer made grants to NEOs within four days before or one day after the release of material non-public information (e.g., periodic report or Form 8-K), then must disclose details about those grants in a tabular format, including the percentage change in the market value.

New Grant Policy and Practices Disclosure – Tabular Disclosure

Name (a)	Grant date (b)	Number of securities underlying the award (c)	Exercise price of the award ($/Sh) (d)	Grant date fair value of the award (e)	Percentage change in the closing market price of the securities underlying the award between the trading day ending immediately prior to the disclosure of material nonpublic information and the trading day beginning immediately following the disclosure of material nonpublic information (f)
PEO					
PFO					
A					
B					
C					

SEC's Cybersecurity Rule Updates

The Rule became effective September 5, 2023. The 8-K Incident Disclosure Requirement became effective December 18, 2023 (or June 15, 2024 for SRCs). The 10-K Annual Disclosure Requirement began with annual reports for first fiscal year ending on after December 15, 2023

Requires Annual Governance and Risk Management disclosures in Form 10-K

Requires Periodic Reporting of Material Cybersecurity Incidents

- Must file a Form 8-K to disclose a material cybersecurity incident within four business days from the date on which the registrant determines that the incident is considered material to the registrant

SEC's Cybersecurity Rule Updates - Risk Management and Strategy

Form 10-K must disclose how the registrant assesses, identifies, and manages material risks from cybersecurity threats, including:

- Integration of cybersecurity processes into overall risk management system
  - *Including privacy-specific processes such as addressing violations of privacy laws, litigation risk, and other legal risk*
- Whether the registrant engages assessors, consultants, auditors, etc. in connection with any such processes
- Processes to oversee and identify material risks from cybersecurity threats associated with its use of any third-party service provider

SEC's Cybersecurity Rule Updates - Governance

Form 10-K must also disclose the registrant's governance practices, including:

- Board's **oversight of risks** from cybersecurity threats
- Board **committee or subcommittee** responsible for oversight of risk from cybersecurity threats (if applicable)
- How the Board/Committee is **informed** of cybersecurity risk
- **Management positions or committees** responsible for such risks, and their relevant **expertise**
- How these persons or committees **monitor cybersecurity incidents**
- How management **reports cybersecurity information** to the Board/Committee

SEC's Cybersecurity Rule Updates - Cybersecurity Guidance

SEC staff only issued a few comments on cybersecurity disclosures

- Inconsistent statements regarding use of third parties (e.g., company does not engage/committee does receive updates from third parties).
- Inadequate disclosure regarding the relevant expertise of such persons or members in such detail as is necessary to fully describe the nature of the expertise as required by S-K Item 106(c)(2)(i).

Other SEC staff guidance:

- C&DIs on effect of ransomware payments on the obligation of companies to report material cybersecurity incidents in Item 1.05 8-K filings.
  - Generally concluding that such payments do not relieve companies of obligations to evaluate materiality/make Item 1.05 8-K filings.
- The effect of consultation with or national security findings by the Attorney General.
- Selective disclosure and the ability of companies to rely on traditional Regulation FD practices to share information about material incidents with commercial partners (if comply with FD principles).
- Should use alternative Form 8-K items (such as Item 8.01) instead of Item 1.05 when reporting incidents that have not yet been determined to be material – or that have been found to be immaterial.

SEC's Cybersecurity Rule Updates - Recent SEC Enforcement Actions Connected to SolarWinds Cyberattack

- SolarWinds background
  - SolarWinds cyberattack involved hackers inserting malware into SolarWinds' Orion software updates, allowing attackers to access the networks of numerous SolarWinds customers.
  - As a result, many companies were impacted/required to disclose the incident as material and/or otherwise reference it as part of their broader cybersecurity disclosures.
- In October 2024, SEC charged four companies with making materially misleading disclosures regarding cybersecurity risks and incidents

SEC's Cybersecurity Rule Updates - Recent SEC Enforcement Actions Connected to SolarWinds Cyberattack

- SEC alleged that companies downplayed severity of the incident:
  - Describing the cybersecurity risks as *hypothetical*
  - *Minimizing the impact* by stating that only a limited number of email messages were accessed, while attackers had actually accessed a significant number of files in their cloud sharing environment
  - Providing *generic descriptions* of cyber risks without disclosing the specific intrusion the company had experienced
  - Failing to disclose the *nature and extent of the data exfiltrated* by the attackers, including encrypted credentials
- SEC also alleged that materially misleading disclosures resulted in part from deficient disclosure controls
- Civil Penalties Imposed

SEC's Cybersecurity Rule Updates - Recent SEC Enforcement Actions Connected to SolarWinds Cyberattack

Key Take-Aways and Considerations:

- Importance of Accurate Disclosures (e.g., precise and comprehensive rather than general references)
- Strong Disclosure Controls:
  - Companies should implement and maintain robust disclosure controls and procedures to promptly identify and assess the impact of cyber incidents.
  - Legal counsel should be engaged to work closely with security teams to ensure accurate reporting and to evaluate the potential materiality. Set out process in company's incident response plan and specific guidance should be developed for evaluating materiality in this context
- Stay on top of developments (e.g., SEC guidance, document best practices, benchmark)
- Proactive Risk Management and Mitigation
  - Preparation and deployment of tailored incident response policies and procedures as well as conducting regular risk assessments, employee training through tabletop exercises, and incident response planning

Risk Factor Update Considerations

- Use or impact of artificial intelligence, including AI-washing
- Cybersecurity risks, as well as consistency, or alignment, with 10-K disclosures of risk management and governance.
- Climate change and extreme weather events, taking into account regulatory developments in the EU, California and the SEC, subject to legal challenges
- Supreme Court administrative law decisions, which create uncertainties for federal agency regulations and interpretations (e.g., reversal of *Chevron* for regulated industries)
- Continuing effect of the international conflicts
- Developments in China, including its economic slowdown, tariff challenges and changing U.S. relations, including supply chain implications
- Exposure to commercial real estate

Climate Rules Update

- Prior (currently operative) rules -- last specifically addressed by SEC in 2010
  - Climate change disclosure not expressly required unless "material" to investors
- Divided SEC adopted climate rules March 6, 2024
  - Climate-related risks reasonably likely to have a material impact on its business, results of operations, or financial condition
    - Actual and potential material impacts of such risks
    - Board and management oversight of climate-related risks.
    - Processes for identifying, assessing and managing material climate-related risks.
    - Information about material climate-related targets or goals.
  - Greenhouse gas emissions (scope 1 and 2)
  - Certain climate-related financial metrics in a registrant's audited financial statements

Climate Rules Update

- SEC Climate disclosure rules voluntarily stayed. On April 4, 2024, the SEC announced its decision to voluntarily stay rules pending judicial review of various consolidated Eighth Circuit petitions challenging the validity of those rules.
- Trump SEC pick Atkins has been very critical of SEC rules
  - Some indication rules may never go into effect
- California and EU continue

Climate Rules Update

- California Climate Rules Update – recently indicated lenient enforcement in first year (2026)
  - In 2023, California enacted SB 253 and SB 261 with disclosures due in 2026 with financial penalties for noncompliance.
  - SB 253 "Climate Corporate Data Accountability Act"
    - Disclose **Scope 1 and Scope 2 GHG emissions beginning in 2026** for the prior fiscal year (Scope 3 in 2027)
    - Applies to U.S. public and private companies that do business in California
    - Companies must have a total annual revenues of more than $1 billion in the prior fiscal year
  - SB 261 "Climate-Related Financial Risk Act"
    - An entity must prepare a **climate-related financial risk report on a biennial basis** and make the report available on its corporate website
    - Applies broadly to companies "doing business" in California, such as partnerships, corporations, LLCs, or other business entities
    - Applies to U.S. public and private companies with total annual revenues greater than $500,000
  - On December 5, 2024, California Air Resources Board (CARB) announced that it "**will not take enforcement action for incomplete reporting" under SB 253 during its first year** of implementation in 2026, **as long as reporting entities make a good-faith effort** to comply and retain data relevant to emissions reporting for the prior fiscal year.
  - CARB will allow reporting entities to submit scope 1 and scope 2 emissions from their prior fiscal year that can be determined from information the reporting entity already possessed or was already collecting at the time the enforcement notice was issued—i.e., as of December 5, 2024.
  - CARB will "exercise enforcement discretion for the first reporting cycle," and "will not take enforcement action for incomplete reporting" on the condition that "entities demonstrate good faith efforts to comply with the requirements of the law," are "actively working toward full compliance," and "retain all data relevant to emissions reporting for the entity's prior fiscal year."
- California Rules currently subject to legal challenge by Chamber of Commerce

Other Recent Items

- Legal proceedings disclosure – think twice before describing as without merit
  - Recent case – statement that claims "are without merit" could be materially misleading as to underlying facts if know/should know facts to be true
  - Might say has "substantial defenses" or "plan to vigorously oppose"
- Expand list of examples of material relationships in D&O questionnaires to include close friendships or other close social ties
  - Recent SEC enforcement action against former chairman/CEO and director for violating proxy disclosure rules by standing for election as an independent director without informing the board of his close personal friendship with an executive officer.
- Nasdaq diversity disclosure rule invalidated.
  - In December 2024, the Fifth Circuit invalidated the SEC's approval of the Nasdaq board diversity rule (invoking the "major questions" doctrine).
  - Nasdaq informed companies of no need to comply
- Prepare for EDGAR Next
  - New security requirements for EDGAR filers; compliance date is September 15, 2025 but goes live March 24, 2025
  - Requires individual account credentials to log onto EDGAR, multifactor authentication, authorization of individuals to manage accounts
  - Will require updating process of authorizing and documenting EDGAR filings, including Section 16 and Rule 144 filings

Questions

02

Shareholder Activism Update

Discussion Road Map

1. Advanced Notice Bylaw Developments
2. Growth of Activism Landscape
3. Responses to Activism Landscape
4. Shareholder Proposal Updates

Activists & plaintiff's firms attacking advanced notice bylaws

- Refresh on advanced notice bylaw provisions
- *Kellner v. AIM ImmunoTech*
  - Delaware Court of Chancery held that certain advance notice bylaw provisions were invalid
  - Two provisions in particular have been seized upon by the plaintiffs' class action bar as "low hanging fruit" by which they may extract attorney fees
    - Litigation demand, books and records demand, and/or complaint filed in court
- Public companies are now receiving stockholder demands of the same nature

Activists & plaintiff's firms attacking advanced notice bylaws (cont'd)

Wolf Pack Language

A person shall be deemed to be "**Acting in Concert**" with another person if such person knowingly acts (**whether or not pursuant to an express agreement, arrangement or understanding**) in concert with or in "**substantial parallel with**" [that person if additional factors are met including vague factors such as] . . . "**exchanging information (whether publicly or privately), attending meetings, [and] conducting discussions**"

Activists & plaintiff's firms attacking advanced notice bylaws (cont'd)

Daisy Chain Language

- A person Acting in Concert with another person shall be deemed to be Acting in Concert with any third party who is also Acting in Concert with such other person

- Where a Stockholder Associated Person is defined to include "any person that directly, or indirectly through one or more intermediaries, controls, is controlled by, is under common control with, or is Acting in Concert with such Proponent or Nominating Stockholder or beneficial owner or a Stockholder Associated Person of such Proponent or Nominating Stockholder or beneficial owner"

Activists & plaintiff's firms attacking advanced notice bylaws (cont'd)

- First Steps to Mitigate Risk:
  - Create a written, nonprivileged record re: awareness of *Kellner* and ongoing review of advance notice bylaws
  - Plaintiff/activist must prove that it caused the corporation to correct the offending language by making a demand or filing suit
- Next Steps to Mitigate Risk:
  - Consider amendments to revise or eliminate the "low hanging fruit"

Activism landscape

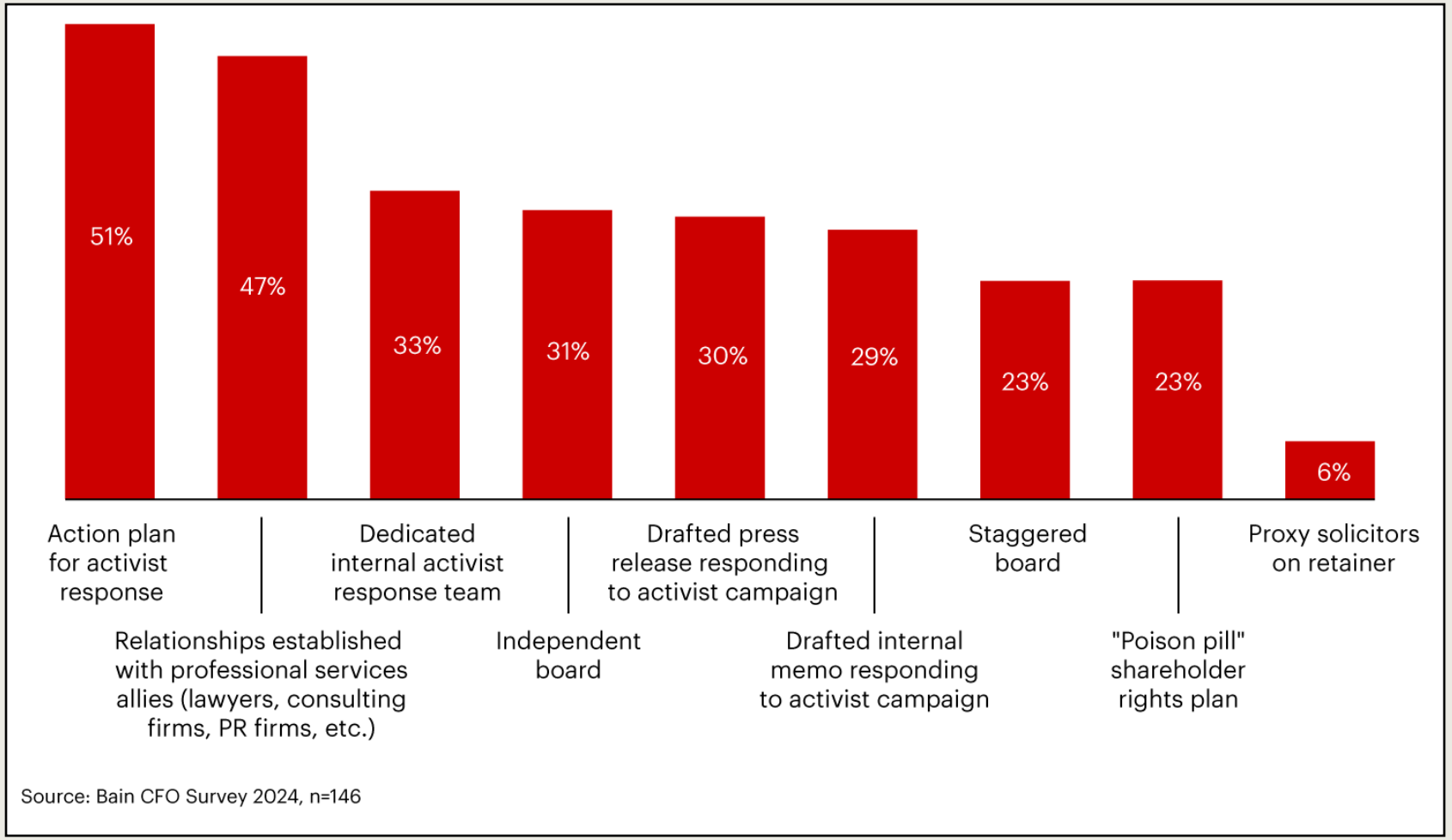
Two decades ago, there were approx. 20 activist campaigns per year

Nearly 1,000 in most recent year

Being big is no defense: Large- and mega-cap companies represented 63% of targeted firms in recent years (up from 44% in 2020)

Activism landscape (cont'd)

Fewer than half of CFOs report having activist defense tactics in place



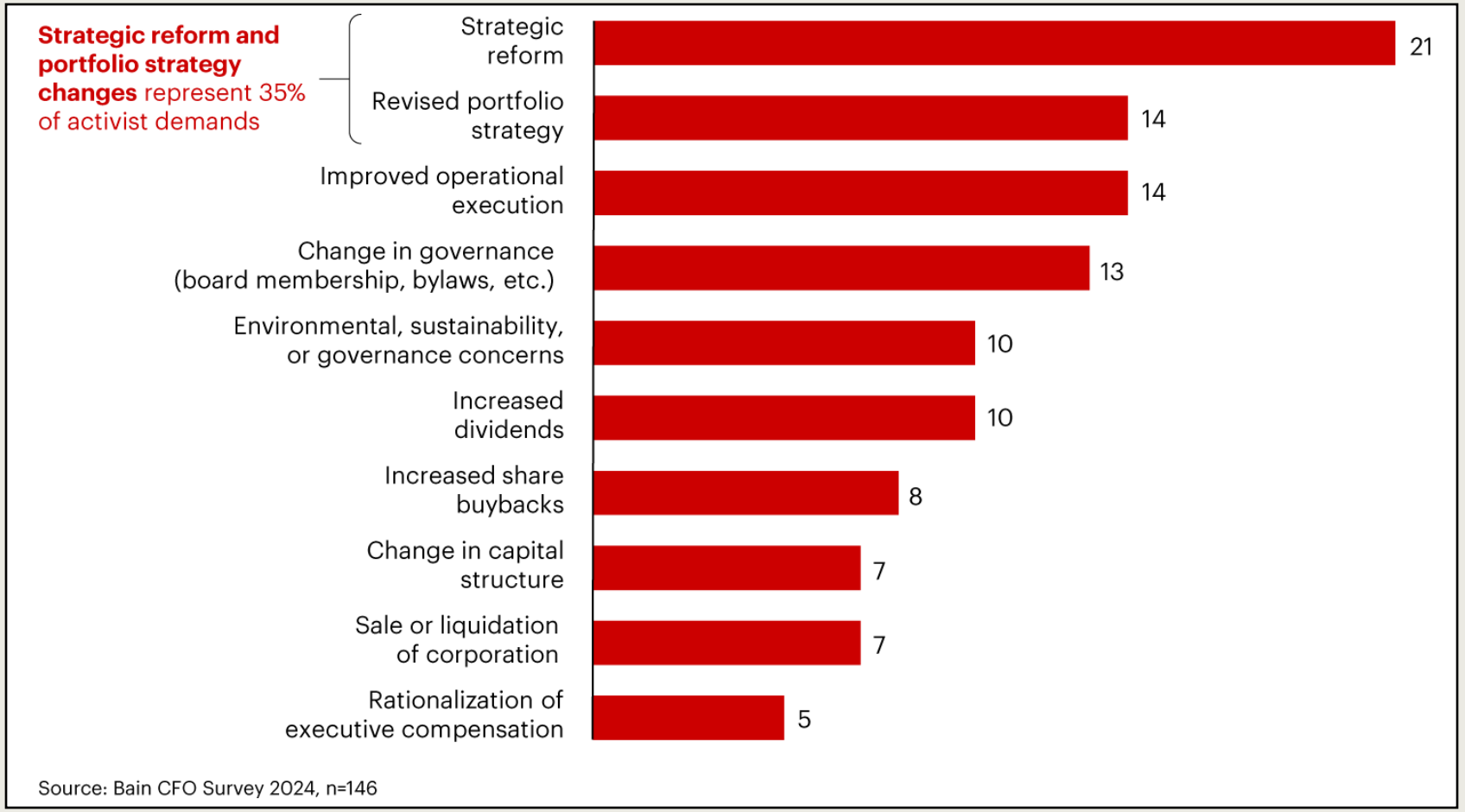
Activism landscape (cont'd)

Companies are increasingly seeing a risk in not engaging with shareholders from a corporate governance standpoint.

Disney, for example, paid tens of millions of dollars as part of its recent proxy fight. More than CEO Bob Iger's total annual compensation.

Activism landscape (cont'd)

Activist demands offer a roadmap for avoiding or defending against them



Activism landscape (cont'd)

Many companies spend millions of dollars in defense, especially during proxy battles that can disrupt strategic direction, leadership, or even corporate control.

Average Cost of Proxy Contest:

2021	2022	2023	2024
• Activist: ~$2.1M • Company: ~$4.6M	• Activist: ~$0.9M • Company: ~$4.0M	• Activist: ~$2.4M • Company: ~$5.3M	• Activist: ~$1.7M • Company: ~$4.4M

Responses to activism landscape

Think like an activist investor

- Roughly one-third of the activist demands focused on strategic reform and revised portfolio strategy
- Taking steps to prepare for activists to anticipate their demands

Responses to activism landscape (cont'd)

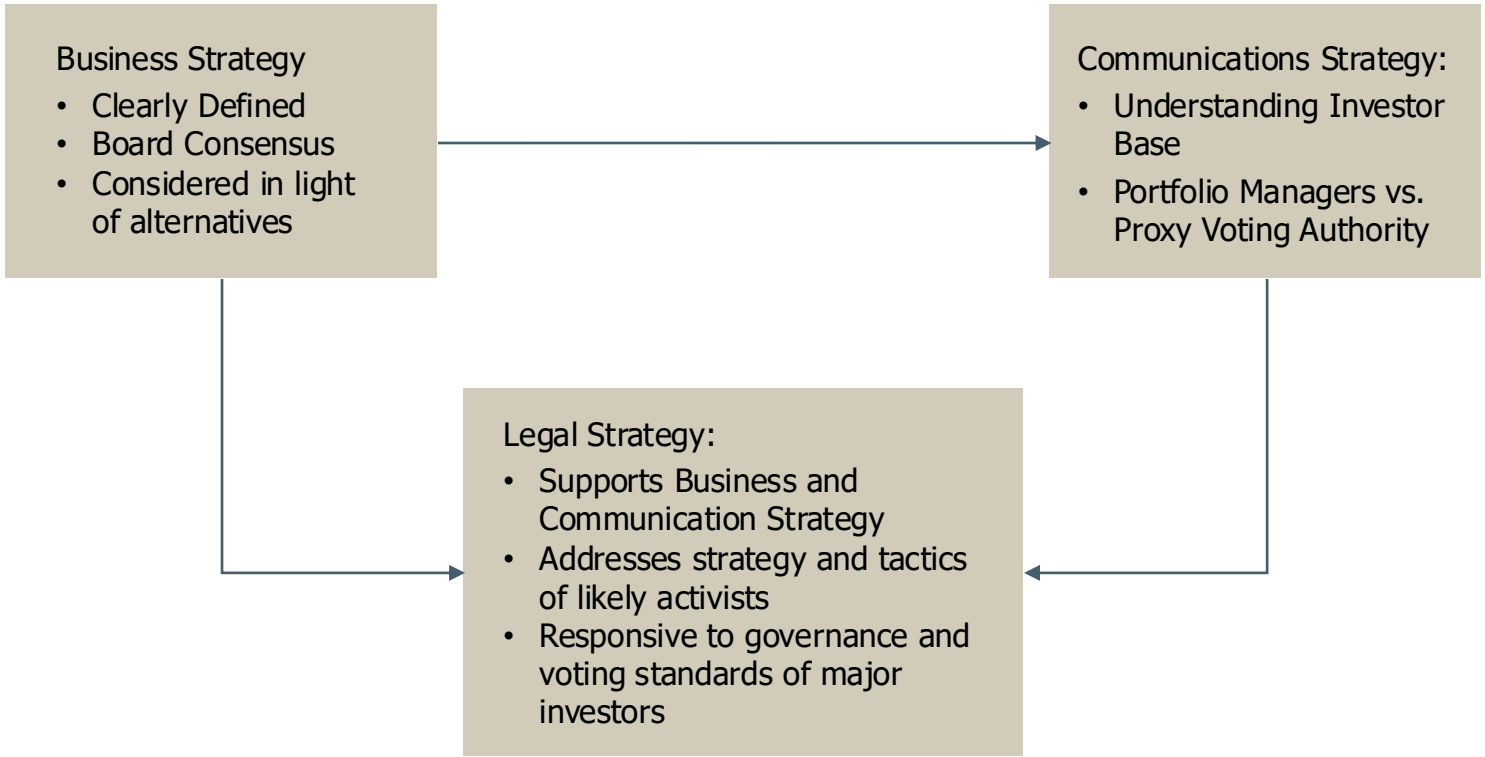
- Decline to engage
- Active listening with no commitments
- Negotiate and enter a settlement agreement
  - Board representation and/or other governance changes
  - Standstill for specified duration
- Pre-emption
- Fight/Resist

Responses to activism landscape (cont'd)

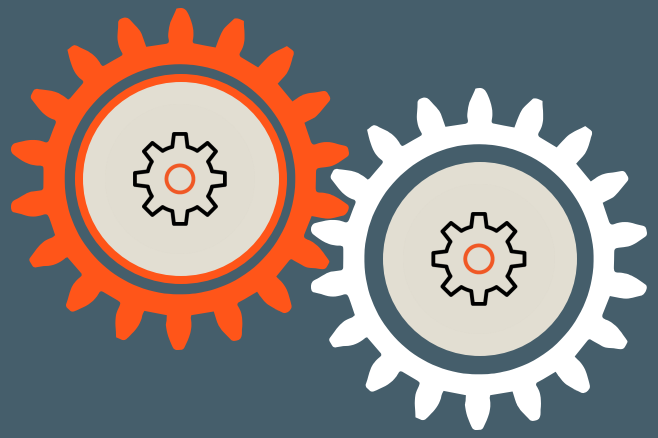
- Regular communication to build a loyal shareholder base
- Consistency in communication around financials, strategy and decision-making to build long-term counter-narrative to activists
- Activist investors tend to target companies with weak investor communication, where they can exploit gaps in shareholder understanding or dissatisfaction
- Tailor communication to key stakeholders
- Monitor shareholder sentiment
- Build a response team

Responses to activism landscape (cont'd)

Key Components of Comprehensive Defense Strategy



Shareholder proposal update



- Shareholder proposals on biodiversity and deforestation averaged 13% support in 2024 – down from 59% in 2022
- Proposals from "anti-ESG" proponents more than quadrupled between 2021 and 2024, but shareholder support remained low (averaging single-digit support)
- Average support declining across all social/political topics, including policymaking focus areas such as diversity and human capital management
- After years of significant growth, environmental submissions remained level overall; overall, support remained consistent, with few passing
- Additional trends expected in 2025

Questions

03

SEC Enforcement Updates

SEC Enforcement investigation process, recent developments, and predictions

Your Speaker

Josh Hess
Partner
Financial Services Disputes and Investigations
Atlanta

Discussion Road Map

1. Big Picture: 2024 SEC Enforcement Results
2. Enforcement Process; Developments About Whistleblower Protections
3. Sanctions; Developments and Predictions
4. Predictions About Enforcement Priorities in the Second Trump Administration

Big Picture: 2024 SEC Enforcement Statistics

- 431 stand-alone enforcement actions; 14% decline vs 2023
- $8.2 billion in financial remedies, the highest ever
- 124 officer-and-director bars
- First Trump Administration brought more enforcement actions than Biden
  - (3,152 vs. 2,824 enforcement actions, and 1,867 vs. 1,829 stand-alone actions)

SEC Enforcement Process

Origins of SEC Investigations

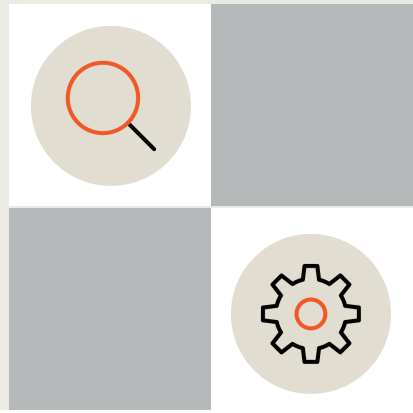
Sources: Public tips, suspicious activity reports, referrals from other agencies

Whistleblowers

- Rewards, 10-30% of total financial sanctions; $255m total in FY 2024
- Dodd Frank prohibits retaliation
- Under SEC Rule 21F-17, cannot impede individual from communicating with SEC, including by confidentiality agreement

Alleged Rule 21F-17 violations

- September 2024 – settled enforcement actions against 7 public companies for impeding whistleblowers; total $3 million in penalties
- Employment, separation, retention, and settlement agreements that
  - Required employees to waive right to recover monetary reward for participating in government investigations
  - Forbade employees from voluntarily providing info to the government and required notice to company of government request for information
- Settled actions acknowledged no evidence that agreements were enforced or that anyone declined to blow the whistle



Early Stages of SEC Investigation

"Matter Under Inquiry" – preliminary review only; no subpoena power – voluntary requests

Formal Order of Investigation

- May be issued by delegated authority (Enforcement Director)
- Authority to issue subpoenas and take oaths

Subpoena recipient may request to review the Formal Order → general insight into nature of investigation

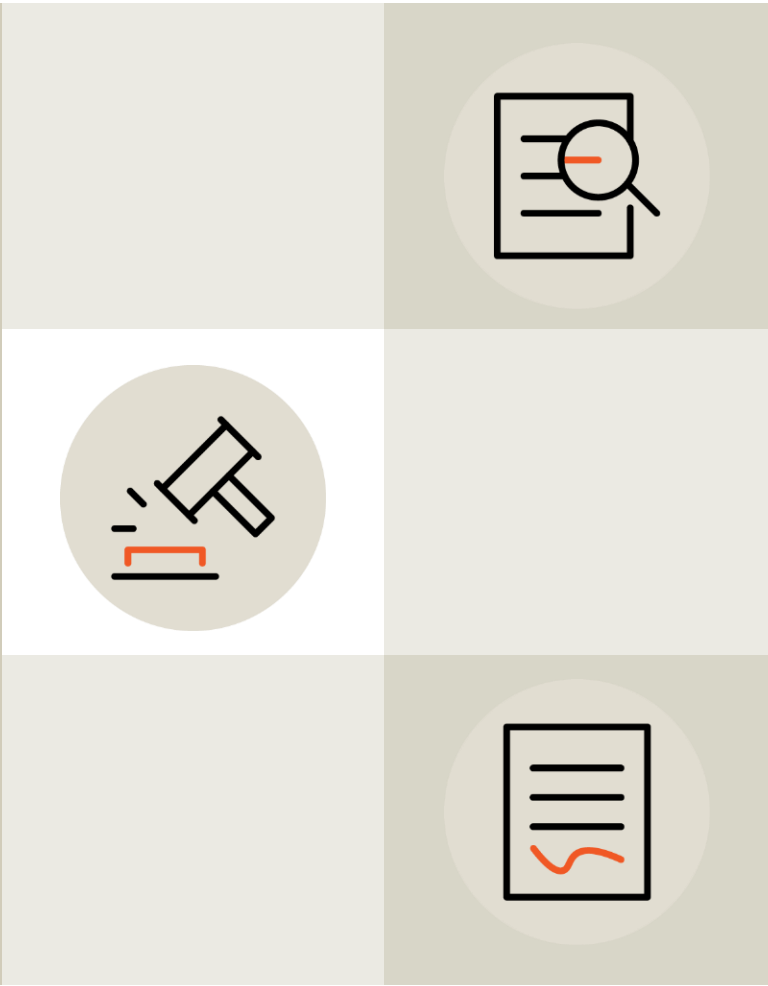
Conducting and Concluding Investigation

- Staff subpoena documents and take testimony
- Wells Notice
- Action memorandum
  - Divisional Review
  - Commission Approval
- Settled or litigated action filed
  - Federal District Court
  - Administrative actions? *SEC v. Jarkesy* (June 2024): Action for fraud, seeking penalty, belongs in court

Sanctions

Examples of Sanctions

- Obey the Law injunction
- Civil Penalty
  - Penalty may not exceed greater (1) tier-based penalty or (2) gross pecuniary gain
  - Per violation
  - Fair Fund for victims
- Disgorgement
- Office and Director Bar
- Undertakings (compliance consultant)



SEC Statement Re: Financial Penalties (Jan. 4, 2006)

Key factors:

- Direct benefit to the corporation from violation?
- Will penalty compensate or harm injured shareholders?

Other Factors

- Deterrence
- Extent of injury to victims
- Widespread Complicity
- Perpetrators' level of intent
- Difficulty in detecting type of offense
- Corporation's remedial steps; cooperation with the SEC

Cooperation Credit

- May reduce or eliminate charges, penalties, or other sanctions
- In FY 2024, SEC noted cooperation by 75% of public company and subsidiary defendants, highest since 2019 (Cornerstone Research/NYU Pollack Center)
- Merely complying with subpoenas not enough

Cooperation Credit

Factors for Corporate Cooperation Credit

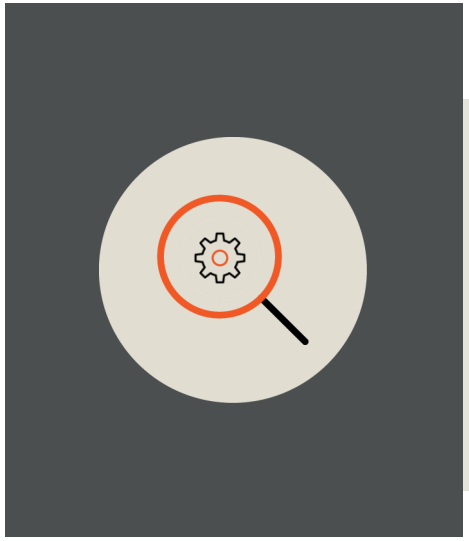
- Self-reporting misconduct
- Remediation, including firing or dismissing individual wrongdoers
- Cooperation with the SEC
  - e.g., presentations about internal investigations, identifying key documents and witnesses, translating key documents
- Self-policing prior to the discovery of misconduct

Respite from Corporate Penalties?

> In financial fraud cases, shareholders, who are the ultimate owners of the corporation on which we impose these penalties, may already have been punished through reputational and stock-price damage.
>
> -Cmr. Paul Atkins (Jan. 19, 2006)

> Corporations are all too willing to pay large civil penalties in exchange for no or lighter sanctions for individuals. I agree…it is usually not right for shareholders to pay for the bad actions of corporate executives.
>
> -Cmr. Hester Peirce (Oct. 26, 2018)

Disgorgement



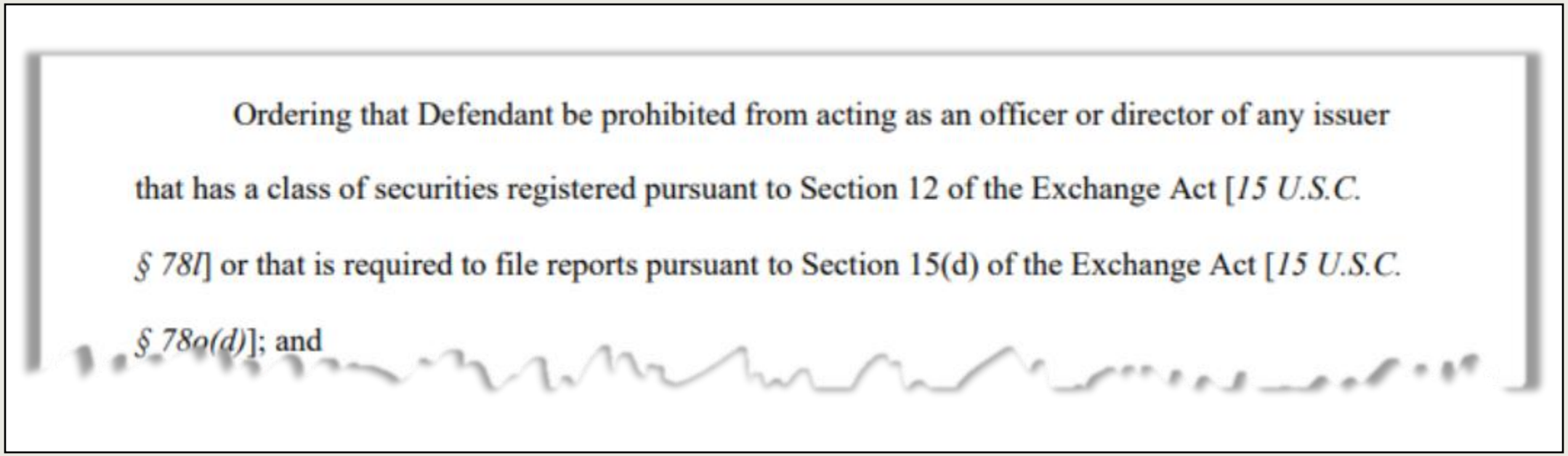
- *Liu v. SEC*, 591 U.S. 71 (2020) – Disgorgement cannot exceed the wrongdoer's net profits
- *SEC v. Govil*, 86 F.4th 89 (2d Cir. 2023) – Only award disgorgement if victims suffered pecuniary harm;
  - *But see SEC v. Nevalliers & Assocs.*, 108 F.4th 19, 41 n.14 (1st Cir. July 16, 2024)
- SEC may deem disgorgement satisfied by amounts the defendant pays in other cases (e.g., criminal case)

Flexible Sanctions

> In any action or proceeding brought or instituted by the Commission under any provision of the securities laws, the Commission may seek, and any Federal court may grant, **any equitable relief that may be appropriate or necessary for the benefit of investors**.
>
> 15 U.S.C. § 78u(d)(5) (emphasis added)

Flexible Sanctions

SEC v. Elon Musk



Ordering that Defendant be prohibited from acting as an officer or director of any issuer that has a class of securities registered pursuant to Section 12 of the Exchange Act [*15 U.S.C. § 78l*] or that is required to file reports pursuant to Section 15(d) of the Exchange Act [*15 U.S.C. § 78o(d)*]; and

Flexible Sanctions

Musk and Tesla have agreed to settle the charges against them without admitting or denying the SEC's allegations. Among other relief, the settlements require that:

- Musk will step down as Tesla's Chairman and be replaced by an independent Chairman. Musk will be ineligible to be re-elected Chairman for three years;
- Tesla will appoint a total of two new independent directors to its board;
- Tesla will establish a new committee of independent directors and put in place additional controls and procedures to oversee Musk's communications;

Enforcement predictions

Prediction: Corporate Disclosure Cases + ESG

In the Matter of Keurig Dr. Pepper Inc.
(Sep. 2024)

The Commission's pedantic parsing of Keurig's recyclability statements and its $1.5 million penalty do little to disguise the weakness of this case.

Cmr. Hester Peirce

In the Matter of Activision Blizzard
(Feb. 3, 2024)

As I read it, in this Order, the SEC once again has sat down at the gaming console to play its new favorite game 'Corporate Manager.' Using disclosure controls and procedures as its tool, it seeks to nudge companies to manage themselves according to the metrics the SEC finds interesting at the moment.

Cmr. Hester Peirce

Prediction: AI Washing

January 2025 Settlement with Public Restaurant-Tech Company

- Licensed to use another company's AI Voice tech
  - Allegedly implied that the tech was proprietary; did not disclose extent of reliance on supplier
- Later developed proprietary tech
  - Allegedly misrepresented that the tech eliminated human order taking; humans often entered orders transcribed by the tech
- "[A]utomated order completion" and "non-intervention" rate allegedly misleading re: role of humans in placing orders
- Negligence-based fraud charge; no penalty due to financial condition, remediation, and cooperation

Prediction: Cybersecurity Cases

October 2024 Settlements

- Alleged Violations:
  - Allegedly failed to update generic cybersecurity risk-factor disclosures in SEC filings to reflect actual cybersecurity breaches
  - Allegedly omitted material details when publicly disclosing cyber events
  - Allegedly failed to maintain internal controls regarding disclosure of cyber events
- Dissent by Cmrs. Peirce and Uyeda

> The common theme across the four proceedings is the Commission playing Monday morning quarterback. Rather than focusing on whether the companies' disclosure provided material information to investors, the Commission engages in a hindsight review to second-guess the disclosure and cites immaterial, undisclosed details to support its charges.

Prediction: Cybersecurity Cases

In the Matter of RR Donnelly & Sons (June 2024)

Every issuer…shall…(B) devise and maintain a system of **internal accounting controls** sufficient to provide reasonable assurances that…(iii) access to assets is permitted only in accordance with management's general or specific authorization…

15 U.S.C. § 78m(b)(2) (emphasis added)

Prediction: Cybersecurity Cases

In the Matter of RR Donnelly & Sons (June 2024)

> 16. RRD failed to reasonably design and maintain internal controls that complied with Exchange Act Section 13(b)(2)(B). Namely, as discussed above, RRD's cybersecurity alert review and incident response policies and procedures failed to adequately establish a prioritization scheme and to provide clear guidance to internal and external personnel on procedures for responding to incidents. In addition, RRD failed to establish sufficient internal controls to oversee the MSSP's review and escalation of the alerts.

Prediction: Cybersecurity Cases

> …Also concerning is the Commission's decision to stretch the law to punish a company that was the victim of a cyberattack. While an enforcement action may be warranted in some circumstances, distorting a statutory provision to form the basis for such an action inappropriately amplifies a company's harm from a cyberattack.
>
> Cmrs. Peirce and Uyeda Dissent

The accounting-controls provision "refers to a company's *financial accounting*." *SEC v. SolarWinds,* 2024 WL 3461952, at *49 (S.D.N.Y. July 18, 2024).

04

Political Landscape

The 2024 election; What happened and what it means

Your Speakers

Jack Oliver
Partner
Public Policy and Government Affairs
St. Louis/Washington, D.C.

Jeff Smith
Executor Director
Missouri Workforce Housing Association
St. Louis

Not submitting for CLE credit – outline to come

05

Hot Topics in M&A/Corporate

Review of recent case law in litigation relating to mergers and acquisitions

Your Speakers

Stephanie Hosler
Partner
Corporate & Finance
Transactions
St. Louis

Emmet P. Ong
Partner
Financial Services
Disputes &
Investigations
San Francisco

Discussion Road Map

1. **Director independence**
2. **Financial advisor disclosures**
3. **Post-closing purchase price adjustment**

Hot Topics - Director Independence

- Default standard of review for corporate transactions in Delaware is business judgment rule, meaning courts will defer to board decision if made:
  - on an informed basis;
  - in good faith and honest belief was in best interests of the company; and
  - by independent and disinterested directors
- Heightened standards of review can be triggered if board labors under a conflict of interest:
  - Enhanced scrutiny
  - Entire fairness
- Standard of review can be **outcome determinative** in litigation

Recent Delaware Decisions

- *In re Match Grp., Inc. Derivative Litig.*, 315 A.3d 446 (Del. 2024). Holding complaint adequately alleged director was not independent when relationship with controller was one of "personal ties of respect, loyalty, and affection"
- *Tornetta v. Musk (Tornetta I)*, 310 A.3d 430 (Del. Ch. 2024). Finding directors not independent due to extensive business and personal ties with controller

Takeaways

- ✓ Check for realized substantial, quantifiable financial benefit resulting from relationship with controller, especially if outsized compared to director's other assets or income
- ✓ Consider the cumulative consequences of all personal and business relationships between controller and director
- ✓ Length of time of the relationship not dispositive but could be a factor, especially if significantly influential for director
- ✓ Deep social relationships between controller and director that include their families are relevant
- ✓ Take account of public expressions of mutual respect and admiration when coupled with a business relationship
- ✓ Service by the director on numerous boards of entities affiliated with the controller, especially where the director cumulatively receives a substantial amount of consideration, should be considered but may not be dispositive

Hot Topics - Financial Advisor Conflicts and Fee Arrangements

- Importance of financial advisors:
  - Fairness opinions
  - Objective, independent financial analysis
  - Safeguard against liability
- Consequences of failing to disclose financial advisor conflicts and fee arrangements:
  - Leaves transaction vulnerable to entire fairness review on grounds the shareholder vote was not fully informed
  - Exposes financial advisors to potential aiding and abetting liability

Recent Decisions

- *City of Sarasota Firefighters' Pension Fund v. Inovalon Holdings, Inc.*, 319 A.3d 271 (Del. 2024). Holding complaint adequately alleged minority shareholder vote was not informed where proxy omitted existence and amount of fees earned by financial advisors from prior and concurrent relationships with counterparties.
- *City of Dearborn Police & Fire Revised Ret Sys. (Chapter 23) v. Brookfield Asset Mgmt.*, 314 A.3d 1108 (Del. 2024). Holding complaint adequately alleged minority shareholder vote was not informed where proxy omitted financial advisor's investment in counterparty.
- *Firefighters' Pension Sys. v. Found. Bldg. Materials, Inc.*, 318 A.3d 1105 (Del. Ch. 2024). Holding complaint adequately alleged breach of fiduciary duty to disclose where information statement omitted that financial advisors' contingency fee was tied, in part, to amount of consideration received by sponsor-controller in the event of a successful sale

Takeaways

- ✓ Consider more robust disclosures about advisor conflicts and fees
- ✓ Keep negotiations over advisor compensation clear of conflicts
- ✓ Be thoughtful about the use of "may"
- ✓ Ensure disclosures in proxy statements closely track board/special committee minutes

Hot Topics – Save Mart Case

- Seller owned 100 percent of the equity in Save Mart Super Markets (Save Mart), a grocery store chain in California and northern Nevada
- Save Mart also owned one-third property interest in a joint venture (GP Interest) relating to another grocery business, Superstore Industries (SSI)
- SSI was listed on Save Mart's books as an equity investment
- Save Mart did not separately list any debt of SSI

Hot Topics – Save Mart Case

- In 2022, Buyer agreed to acquire Save Mart via the Stock Purchase Agreement
- Deal structured as "debt-free, cash-free"
- Seller keeps cash on the business's balance sheet
- Seller eliminates any debt

Hot Topics – Save Mart Case

- Stock Purchase Agreement included Post-Closing Purchase Price Adjustment
- Customary
- Adjustments for changes to Company's Financials Between Signing and Closing
- Amount of Any "Indebtedness" Reduces Final Purchase Agreement

Hot Topics – Save Mart Case

- In March 2022, Buyer delivers to Seller a pre-closing statement reflecting an aggregate purchase price of $39,598,051
- Buyer's statement treated the GP Interest as an equity investment and did not include any debt separately owned by SSI
- Buyer did not object at that time to Seller's accounting methodology, and the parties continued to closing, with Seller expecting an approximately $40 million payment for its interests in the business

Hot Topics – Save Mart Case

- In June 2022, Buyer delivered to Seller its proposed final closing statement, which included $109 million in indebtedness of SSI
- Results in negative purchase price
- Results in **Seller** paying Buyer almost $90 million to acquire the business

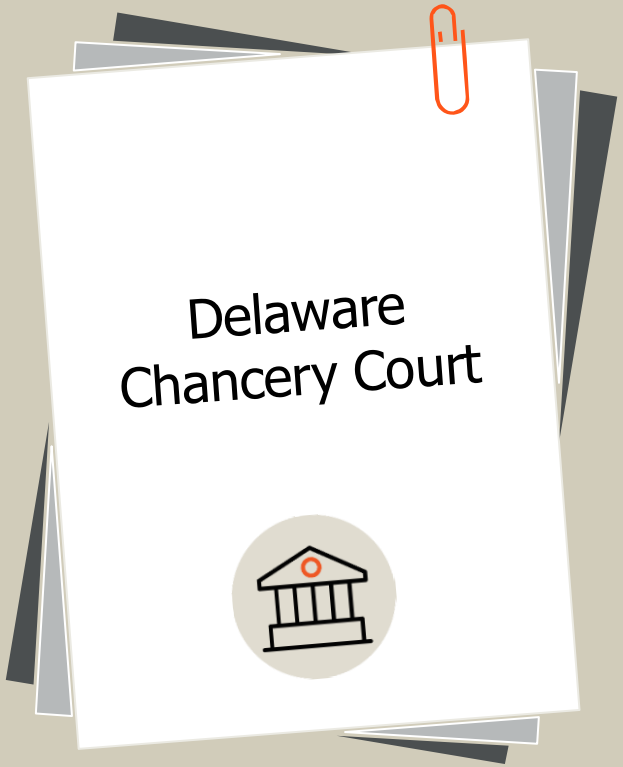
Hot Topics – Save Mart Case

- Conflicting Calculations/Differing Interpretations
- Definition of "Closing Date Indebtedness"
- Stock Purchase Agreement provides that Dispute in Closing Statement Referred to Accounting Referee
- If Unresolved, Goes to Arbitration

Hot Topics – Save Mart Case

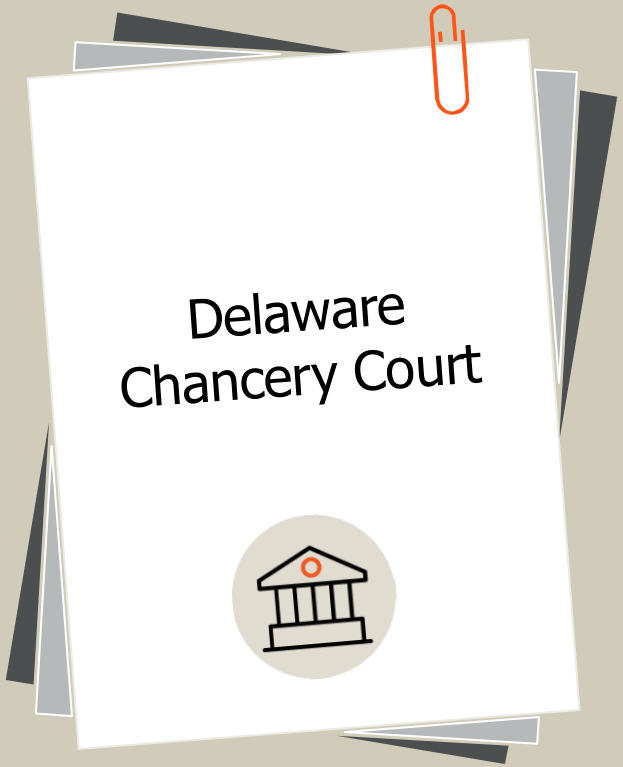
- Arbitrator - Former Vice Chancellor Joseph Slights of the Delaware Court of Chancery
- Applied a strict interpretation of the Closing Date Indebtedness definition
- Upheld Buyer's purchase price calculation
- Clear deviation from the economic realities of the transaction

Hot Topics – Save Mart Case



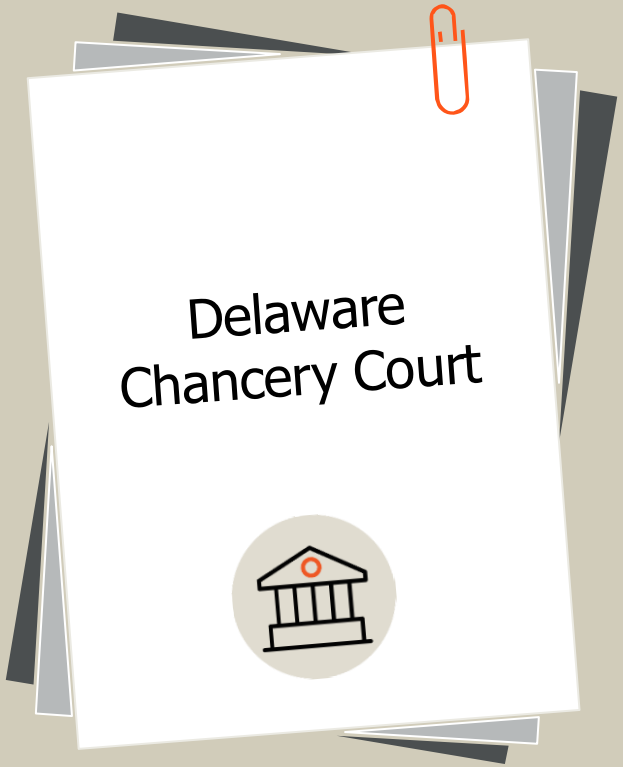
- Then, Buyer files in Delaware Chancery Court to confirm arbitration award
- Delaware Chancery Court - Vice Chancellor J. Travis Laster
- "Economically divorced from the intended transaction"
- Different result if presented the question directly
- Review of an arbitration award – "one of the narrowest standards of judicial review"

Hot Topics – Save Mart Case



- Requires affirming the award unless showing is made that the arbitrator acted in "manifest disregard of the law"
- This requires "that the arbitrator (1) knew of [a] relevant legal principle, (2) appreciated that this principle controlled the outcome of the disputed issue, and (3) nonetheless wilfully flouted the governing law by refusing to apply it."
- Award affirmed if the arbitrator "is even arguably construing or applying the contract and acting within the scope of his authority[.]"

Hot Topics – Save Mart Case



- Seller could not demonstrate that Arbitrator showed manifest disregard for the law
- Vice Chancellor Laster confirmed the award
- Seller has now appealed to the Delaware Supreme Court

Hot Topics – Save Mart Case

- Delaware courts' strict application of contract terms – does not matter if not "fair"
  - Strict Interpretation
  - Careful Reading
- Very narrow ability to challenge arbitration award
- "Delaware law is more contractarian than most, and Delaware courts will enforce the letter of the parties' contract without regard for whether they have struck a good or bad deal[.]"
- Unlikely Delaware Supreme Court will reverse arbitration award

07

Benefits and Compensation Trends

Recent developments and trends for employee benefit plans and executive compensation

Your Speakers

Steve Evans
Partner
Tax, Employee Benefits and Private Client
St. Louis

Meredith Silliman
Associate
Tax, Employee Benefits and Private Client
Charlotte

Discussion Road Map

1. **Employee benefit plans and executive compensation**
   - Cybersecurity guidance
2. **Employee benefit plans**
   - Forfeiture lawsuits
   - Defined benefit pension plan considerations
   - SECURE, CARES, and SECURE 2.0 Acts
   - Increased focus on health and welfare compliance
3. **Executive compensation**
   - Fringe benefits
   - Impeding whistleblowing activity
   - Equity award timing

Cybersecurity guidance

Emerging ERISA cybersecurity claims have generally been brought under two different theories:

Participant data is a plan asset entitled to same fiduciary protections & prohibited transactions rules applicable to plan funds

- Participant data should only be used for exclusive purpose of providing plan benefits
- Prohibits arrangements where vendor (e.g., record keeper) or affiliated company uses data to market non-plan product & services to plan participants
- Prohibits failing to consider the "value of the vendors' access to plan participants & their data for marketing purposes" when establishing recording-keeping pricing
- Courts are split on this theory

Failure to protect access to participants' benefits (e.g., a fraudulent withdrawal) is a breach of plan fiduciaries' standard of loyalty & care

- DOL guidance provides clear path for this litigation

Cybersecurity guidance (cont'd)

- Two rounds of DOL guidance: Initial guidance was released April 14, 2021, and applied to retirement plans; updated guidance released September 6, 2024, and was expanded to health and welfare plans
- SEC has published mandatory cybersecurity incident reporting requirements for all U.S. listed public companies
- State laws may also be relevant
  - E.g., comprehensive state privacy laws, data breach laws, financial privacy
  - Note, Missouri and Illinois have not enacted comprehensive privacy laws
- Following the DOL guidance, we have seen DOL audits include an extensive list of cybersecurity-related requests

Cybersecurity guidance (cont'd)

Top five takeaways:

Maintain formal, well documented cybersecurity program

- Policy should include Written Information Security Program; Cyber & Information Security Policy; Incident Response Plan; Business Continuity Plan; and Vendor Contract Management Plan

Conduct periodic cybersecurity training, including ensuring readiness for breach management, annual risk assessments, and third party audits of security controls

Obtain adequate insurance coverage

- Most cybersecurity policies are enterprise-wide, do not acknowledge benefit plans specifically, and will not address losses relating to the theft of funds

Educate participants to protect accounts

- Register, set up & routinely monitor online accounts; use strong & unique passwords; use multi-factor authentication; keep personal contact information current; close or delete unused accounts; be wary of free-wifi; be wary of phishing attacks

Follow vendor selection best practices

Cybersecurity guidance (cont'd)

Vendor selection:

- Review vendor's information security standards, practices & policies, and audit results, and compare them to industry standards adopted by other vendors
- Determine how vendor validates its practices and what levels of security standards it has met/implemented; seek right to review audit results demonstrating compliance with the standard
- Evaluate vendor's track record, including public information regarding information security incidents, other litigation, and legal proceedings related to vendor's services
- Inquire about past security breaches, what happened, & how vendor responded
- Confirm vendor has insurance policies to cover losses caused by cybersecurity & identity theft breaches, both internal & external
- Ensure contract requires ongoing compliance with cybersecurity & information security standards
- Beware contract provisions that limit responsibility for IT security breaches
- Include contract terms that enhance cybersecurity protection for plan & participants

Forfeiture lawsuits

Approximately two (2) dozen lawsuits have been filed since the Fall of 2023 against employers and plan fiduciaries regarding how forfeited employer contributions are used in retirement plans

Plaintiffs have claims that, in choosing to use forfeitures to reduce employer contributions instead of reducing administrative expenses charged to participants, participants were harmed

Many plan documents have historically provided discretionary authority over how forfeitures were allocated (e.g., the plan administrator may use forfeitures to pay reasonable expenses or to reduce employer contributions)

Including plan terms that eliminate discretion by directing how forfeitures are to be used can mitigate litigation risk:

Not later than twelve (12) months after the close of the Plan Year in which any forfeitures are incurred or any later date as may be provided by applicable law, amounts attributable to forfeitures shall be applied in the following order, each to the full extent of forfeitures then remaining: (a) to pay Plan administrative expenses, (b) to reduce Plan Sponsor contributions, (c) to restore previously forfeited amounts to a Participant's Account pursuant to the terms of the Plan, (d) to be treated as qualified nonelective contributions or qualified matching contributions, and (e) to make Plan Sponsor contributions pursuant to the Employee Plans Compliance Resolution System, to the extent permissible under applicable guidance.

Consider affiliate participation in a plan if division-specific forfeiture accounts are maintained

Defined benefit pension plan considerations

- Increased M&A activity
  - Be aware of reportable event notice requirements that require disclosure of certain information (e.g., changes in your controlled group)
- Increased de-risking activity
  - E.g., lump sum windows or asset transfers (a.k.a. "lift-outs")
  - Evolving issue under SECURE 2.0 and DOL guidance
  - Over the last twelve (12) months, there has been renewed interest from plaintiff's firms challenging asset transfers to alleged "risky" insurers
  - Following established precedents, DOL guidance, and a prudent process can mitigate the litigation risk

SECURE, CARES, and SECURE 2.0 Acts

- Recently enacted laws made significant changes intended to simplify retirement plan rules, improve retirement outcomes, and offer new benefit options for employers and employees
- Your HR teams have likely been working closely with retirement plan vendors to ensure that each plan is operating in compliance with current, applicable law even though plan amendments are not yet required
- Many provisions are optional, requiring your team to make decisions about which provisions to adopt/implement, but several are mandatory, requiring your team to ensure that timely implementation occurs

If any of your plans exclude part time employees (outright or via 1,000 hours of service requirements), changes went into effect January 1, 2024

SECURE, CARES, and SECURE 2.0 Acts (cont'd)

- Increased Catch-Up Contributions: Participants ages 60-63 *may be permitted* to make catch-up contributions equal to the greater of $10k or 150% of the general catch-up limit for the year
- Matching contributions on student loan repayments: Employers can now make matching contributions to a 401(k) plan on employees' qualifying student loan repayments
- Retirement Plan-Linked Emergency Savings Accounts: Employers may establish emergency savings accounts in 401(k) plans that permit employees to withdraw limited amounts without the 10% early withdrawal penalty
- Penalty Free Withdrawals: Victims of domestic abuse, participants with a terminal illness, participants with long-term care insurance premiums, and participants with an unforeseeable or immediate financial need related to a necessary or personal family emergency are permitted to take distributions without the 10% early withdrawal penalty

Increased focus on health and welfare compliance

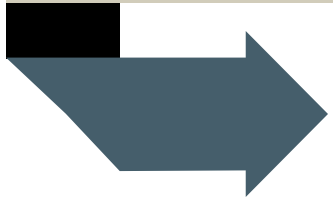
The DOL has indicated that it is working toward spending 50% of its time on health and welfare plan-related matters, which is a drastic shift from its historic practice

- Assuming you have a benefits committee, does it include health and welfare matters in its meeting agendas?
- How are claims handled?
- Have you reviewed your vendor agreements to identify areas where additional transparency may be advisable (e.g., pharmacy benefit management)?
- Are all staffing agencies complying with the PPACA?
- Recent update on PPACA statute of limitations (six years!)

Fringe benefits

The SEC has ramped up its enforcement action related to inadequate disclosure of perquisites paid to executives, imposing significant financial penalties and, in some instances, the requirement that independent consultants review policies, procedures, controls and training relating to reporting and disclosure

While personal use of company aircraft has been a specific focus, there is a low threshold for disclosure, meaning that even seemingly minor benefits should be reported



We recommend reviewing your internal reporting and disclosure controls and policies and procedures related to the identification, valuation, documentation, and tracking of perquisites, including any related person transactions

Impeding whistleblowing activity

The SEC has taken an expansive view regarding language in any service-related agreement that could impede whistleblower activity

Employees, former employees, contractors, and consultants

Employment, compensation, severance, contractor, consulting, and similar agreements and policies are all at-issue

We recommend reviewing existing agreements and ensuring future agreements:

- Expressly allow sharing information with the SEC regarding possible securities law violations
- Do not require notice to be provided to or consent obtained from the company before reporting potential legal violations
- Do not restrain or prohibit individuals from receiving monetary recovery (an SEC "bounty") in connection with providing information to the SEC related to securities law violations
- Are carefully tailored when requiring representations by an individual in a severance agreement relating to complaints or charges against the company

Equity award timing

Public companies must provide detailed tables for grants of options, SARs, and similar instruments to Named Executive Officers (NEOs) made within four days before or one day after the release of material non-public information

Consider whether to adopt or revise policies relating to timing of such grants in relation to material announcements:

- Regularizing and limiting the number of grant dates, ideally during quarterly window periods following the filing of 10-Ks or 10-Qs, when the company is no longer aware of any other material non-public information
- Adjusting the timing of action in respect of such grants or whether to determine the exercise price based on the market price after the filing of such reports (adjustments come with their own compliances issues – e.g., Section 409A exercise price)
- Establishing requirements for off-cycle awards, such as for new hires or promotion or retention, to require pre-clearance to confirm no anticipated disclosure of material non-public information
- Avoiding making grants to NEOs within four days before or one day after filings of 10-Ks, 10-Qs or 8-Ks containing material non-public information

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