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SELECTED RECENT DEVELOPMENTS FOR PUBLIC COMPANIES

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SUMMARY

Public companies should take note of several recent developments, including:

- Reversal of the Pegasystems trade secrets lawsuit that nevertheless preserves guidance to take care when describing litigation as "without merit".
- Recent Delaware law changes that provide flexibility for stockholder agreements establishing corporate governance requirements but also some uncertainty.
- Increased SEC focus on disclosures related to artificial intelligence.
- Trends in risk factor disclosures related to recent U.S. Supreme Court administrative law decisions.

CONTINUE TO TREAD CAREFULLY IF DESCRIBING LAWSUITS AS "WITHOUT MERIT"

As discussed in our August 7, 2023 post, Pegasystems Inc. and its CEO lost motions to dismiss securities fraud claims based on:

- Statements in 10-Qs and 10-Ks that a competitor's trade secrets lawsuit was "without merit."
- Assurances in the code of conduct that the company would not use "illegal or questionable means to acquire a competitor's trade secrets or other confidential information."

The claims were filed shortly after a $2 billion trade secrets verdict awarded to one of the company's competitors arising out of a corporate espionage campaign.

After our post:

- In April, Pegasystems settled the securities fraud claims for $35 million.
- Last month, the Virginia Court of Appeals reversed the $2 billion judgment and ordered a new trial, based on evidentiary and jury instruction errors.

However, the lessons provided by the case remain relevant:

- Review disclosure controls and procedures relating to litigation.
  - Be sure mechanisms are in place for input from relevant officers and employees.
- Be cautious about using boilerplate language characterizing litigation as "without merit".
  - Consider alternatives such as "the company plans to assert vigorous defenses" or, if reasonably supported, "the company believes that it has substantial defenses".
- Review codes of conduct and evaluate in light of corporate practices and stock exchange requirements.

RECENT DELAWARE LAW CHANGES TO PERMIT GOVERNANCE RESTRICTIONS IN STOCKHOLDER AGREEMENTS PROVIDE BOTH FLEXIBILITY AND UNCERTAINTY

Effective August 1, 2024, Delaware amended its corporate statute to permit companies, among other things, to contract with stockholders to restrict or prohibit actions or require consent or approval of matters that might otherwise be viewed as contrary to director fiduciary duties, including director nomination rights, board composition and size requirements, and governance consent rights. These types of provisions commonly appear in venture-backed investor rights agreements, proxy contest settlements and private equity arrangements for IPO companies.

The changes were designed to address a Delaware Chancery Court decision in West Palm Beach Firefighters' Pension Fund v. Moelis & Company in February that invalidated various corporate governance covenants contained in a stockholder agreement, while acknowledging such provisions would be permissible in the certificate of incorporation. The final language reflects amendments confirming that no provision of a contract shall be enforceable against the company to the extent contrary to the certificate of incorporation or state law if included in the certificate of incorporation.

Other changes include:

- Providing greater flexibility to contract for specific pre-closing remedies in M&A and address post-closing matters, such as indemnities, earn-outs and working capital adjustments.

- Allowing board action to approve a merger agreement in either final or substantially final form, as well as to ratify an agreement before the certificate of merger is filed. Although disclosure schedules are not deemed part of such an agreement, the amendments do not relieve the board of its duty of care to consider material elements.

The amendments gave rise to controversy, including:

- Objections by CII to allowing stockholder agreements to impose governance restrictions as contrary to the interests of long-term investors: July 10, 2024 CII letter to Delaware.
- Criticism by prominent law professor to allowing boards boards to contract away powers without shareholder input: Letter in Opposition to the Proposed Amendment to the DGCL.

As illustrated by a law professor's speculation as to the potential inadvertent revival of dead-hand pills, the full impact of the amendments may not be known until after future lawsuits are resolved. In particular, the amendments do not alter the fiduciary duties of directors.

SEC INCREASING FOCUS ON DISCLOSURES RELATED TO ARTIFICIAL INTELLIGENCE

As discussed in our May 24, 2023 post, issues related to artificial intelligence continue to proliferate. Recent developments include recent SEC enforcement actions for "AI washing," as discussed in our June 20, 2024 post.

In late June, the Director of the SEC's Division of Corporation Finance published remarks addressing artificial intelligence as a disclosure priority, stating:

> "As companies incorporate the use of artificial intelligence into their business operations, they are exposed to additional operational and regulatory risks. A number of existing rules or regulations may require disclosure about how a company uses artificial intelligence and the risks related to its use, including disclosure in the description of business section, risk factors, MD&A, the financial statements, and the board's role in risk oversight. In 2024, the Division staff will consider how companies are describing these opportunities and risks, including, to the extent material, whether or not the company:
>
> - clearly defines what it means by artificial intelligence and how the technology could improve the company's results of operations, financial condition, and future prospects;
> - provides tailored, rather than boilerplate, disclosures, commensurate with its materiality to the company, about material risks and the impact the technology is reasonably likely to have on its business and financial results;

- focuses on the company's current or proposed use of artificial intelligence technology rather than generic buzz not relating to its business; and
- has a reasonable basis for its claims when discussing artificial intelligence prospects."

As discussed in our June 20, 2024 post:

> "As use of artificial intelligence in businesses continues to expand, the temptation to highlight its applications can also grow. Companies should exercise care to ensure that any discussion of AI is supported with internal documentation and balanced in presentation, with appropriate consideration of risks and limitations."

CONSIDER RELEVANCE OF RISKS RESULTING FROM U.S. SUPREME COURT ADMINISTRATIVE LAW DECISIONS

As discussed in our July 9, 2024 post, several recent U.S. Supreme Court decisions create uncertainties for federal agency regulations and interpretations. This month, a number of companies included risk factors in their quarterly filings addressing those decisions and potential risks they create. A majority came from the life sciences or healthcare industries. See the examples included in **Exhibit A** below,

Companies that operate in regulated industries, as well as those that rely on established regulatory environments, should evaluate potential risks of future challenges to agency rules or interpretations – particularly by competitors that operate at a regulatory disadvantage.

EXHIBIT A

EXAMPLES OF RECENT 10-Q RISK FACTOR DISCLOSURES

ZIPRECRUITER

Ziprecruiter

> ***We are subject to a wide variety of foreign and domestic laws. As we look to expand our international footprint over time and as new domestic laws are implemented, we may become obligated to comply with additional laws and regulations of the countries or markets in which we operate or have employers and job seekers.***

Further, in June 2024, the U.S. Supreme Court reversed its longstanding approach under the Chevron doctrine, which provided for judicial deference to regulatory agencies. As a result of this decision, we cannot be sure whether there will be increased challenges to existing agency regulations or how lower courts will apply the decision in the context of other regulatory schemes without more specific

guidance from the U.S. Supreme Court. For example, the U.S. Supreme Court's decision could significantly impact consumer protection, advertising, privacy, artificial intelligence, anti-corruption and anti-money laundering practices and other regulatory regimes with which we are required to comply.

New approaches to policymaking and legislation may also produce unintended harms for our business, which may impact our ability to operate our business in the manner in which we are accustomed. Any of these regulations could negatively impact our users, including perceptions regarding their use of our marketplace, or have a material adverse effect on the demand for job postings in our marketplace or on how we operate our marketplace.

GOPRO

GoPro

> ***We are subject to governmental regulation and other legal obligations, particularly related to privacy, data protection and information security, and our actual or perceived failure to comply with such obligations could adversely affect our business and operating results.***

Future laws, regulations, standards and other obligations, as well as changes in the interpretation of existing laws, regulations, standards and other obligations could impair our ability to collect, use or disclose information relating to individuals, which could decrease demand for our products, require us to restrict our business operations, increase our costs, and impair our ability to maintain and grow our customer base and increase our revenue. For example, in June 2024 in *Loper Bright Enterprises v. Raimondo* (Loper) the Supreme Court held that courts need not defer to a governmental agency's interpretation of an ambiguous statute that it administers but can consider an administrative agency's interpretation when it falls within such agency's purview, or adhere to a less deferential standard. As a result of Loper, we cannot be sure whether there will be increased challenges to existing agency regulations or how lower courts will apply Loper in the context of other regulatory schemes without more specific guidance from the Supreme Court.

The Supreme Court's decision in Loper could significantly impact ESG regulation with respect to agency guidance previously issued on greenhouse gas emissions, sustainable investing and advertising, workplace and board diversity, and anti-corruption measures. Any inability to adequately address privacy and security concerns, even if unfounded, or comply with applicable laws, regulations, policies (including ESG-related policies), industry standards, contractual obligations or other legal obligations could result in additional cost and liability to us, damage our reputation, inhibit sales, and adversely affect our business and operating results.

SUTRO BIOPHARMA

Sutro Biopharma

Even if we receive regulatory approval for any of our product candidates, we will be subject to ongoing regulatory obligations and continued regulatory review, which may result in significant additional expenses. Additionally, our product candidates, if approved, could be subject to labeling and other restrictions and market withdrawal. We may also be subject to penalties if we fail to comply with regulatory requirements or experience unanticipated problems with our products.

We also cannot predict the likelihood, nature or extent of government regulation that may arise from future legislation or administrative or executive action, either in the United States or abroad. Further, three decisions from the U.S. Supreme Court in July 2024 may lead to an increase in litigation against regulatory agencies that could create uncertainty and thus negatively impact our business. The first decision overturned established precedent that required courts to defer to regulatory agencies' interpretations of ambiguous statutory language. The second decision overturned regulatory agencies' ability to impose civil penalties in administrative proceedings. The third decision extended the statute of limitations within which entities may challenge agency actions. These cases may result in increased litigation by industry against regulatory agencies and impact how such agencies choose to pursue enforcement and compliance actions. However, the specific, lasting effects of these decisions, which may vary within different judicial districts and circuits, is unknown. We also cannot predict the extent to which FDA and SEC regulations, policies, and decisions may become subject to increasing legal challenges, delays, and changes.

ALTO INGREDIENTS

Alto Ingredients

The United States Supreme Court's decision in the case of Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc. may result in less industry-favorable rulemaking and agency interpretations of laws and regulations, which could materially and adversely affect our results of operations, cash flows and financial condition as well as the business and financial prospects of certain capital improvement projects, such as CCS.

The United States Supreme Court, in the landmark case of Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc., recently overturned its prior doctrine of judicial deference to administrative interpretations of laws and regulations. This outcome could materially and adversely affect rulemaking and agencies' interpretations favorable to the renewable fuels industry, such as the EPA's administration of the Renewable Fuel Standard. This outcome could also materially and adversely affect the Treasury Department's ability to promulgate favorable regulations under the Inflation Reduction Act of 2022, including tax credits such as the 45Q carbon capture and storage tax credits, and other industry-favorable tax credits. Less industry-favorable rulemaking and agency

interpretations of laws and regulations could materially and adversely affect our results of operations, cash flows and financial condition as well as the financial prospects of certain capital improvement projects, such as CCS.

FORTE BIOSCIENCES

Forte Biosciences

Even if Forte receives regulatory approval of any product candidate, Forte will be subject to ongoing regulatory compliance obligations and continued regulatory review, which may result in significant additional expense. Additionally, if Forte fails to comply with regulatory requirements or experiences unanticipated problems with its product candidate, if approved, Forte could be subject to labeling and other restrictions, market withdrawal, and penalties.

The policies of the FDA and of other regulatory authorities may change and additional government regulations may be enacted that could prevent, limit or delay regulatory approval of any product candidate Forte develops. For example, the government may implement additional measures in response to any resurgence of the COVID-19 pandemic or other public health emergencies. Recently, the U.S. Supreme Court overruled the Chevron doctrine, which gives deference to regulatory agencies' statutory interpretations in litigation against federal government agencies, such as the FDA, where the law is ambiguous. This landmark Supreme Court decision may invite more companies and other stakeholders to bring lawsuits against the FDA to challenge longstanding decisions and policies of the FDA, including FDA's statutory interpretations of market exclusivities and the "substantial evidence" requirements for drug approvals, which could undermine the FDA's authority, lead to uncertainties in the industry, and disrupt the FDA's normal operations, any of which could delay the FDA's review of our regulatory submissions. We cannot predict the full impact of this decision, future judicial challenges brought against the FDA, or the nature or extent of government regulation that may arise from future legislation or administrative action. Forte cannot predict the likelihood, nature or extent of government regulation that may arise from future legislation or administrative or executive action, either in the United States or abroad. To the extent any legislative, administrative, or executive actions impose constraints on the FDA's ability to engage in oversight and implementation activities in the normal course, its business may be negatively impacted. In addition, if Forte is slow or unable to adapt to changes in existing requirements or the adoption of new requirements or policies, or if Forte is not able to maintain regulatory compliance, Forte may lose any marketing approval that Forte may have obtained, and Forte may not achieve or sustain profitability.

Non-compliance by Forte or any future collaborator with regulatory requirements, including safety monitoring or pharmacovigilance requirements, can also result in significant financial penalties.

ITERUM THERAPEUTICS

Iterum Therapeutics

> ***Healthcare legislative reform measures may have a material adverse effect on our business and results of operations.***

In addition, several significant administrative law cases were decided by the U.S. Supreme Court in 2024, most notably *Loper Bright Enterprises v. Raimondo*, which overruled *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc*. Since 1984, Chevron had required that courts defer to reasonable agency interpretations of statutes and agency action. In Loper Bright, the Supreme Court held that the U.S. Administrative Procedure Act requires courts to exercise their independent judgment when deciding whether an agency has acted within its statutory authority, and that courts may not defer to an agency interpretation solely because a statute is ambiguous. These decisions may result in additional legal challenges to regulations and guidance issued by federal regulatory agencies, including the FDA and CMS, that we have relied on and intend to rely on in the future. Any such challenges, if successful, could have an impact on our business, and any such impact could be material. In addition to potential changes to regulations and agency guidance as a result of legal challenges, these decisions may result in increased regulatory uncertainty and delays in and other impacts to the agency rulemaking process, any of which could adversely impact our business and operations.

MEET THE TEAM

R. Randall Wang

St. Louis

randy.wang@bclplaw.com
+1 314 259 2149

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