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# Fenwick Securities Law Update

## – November 25, 2024 –

Welcome to the latest edition of Fenwick's Securities Law Update. This issue contains updates and important reminders on:

- Form 10-K and proxy statement disclosures and upcoming compliance deadlines
- Glass Lewis releasing its 2025 Proxy Voting Policy Guidelines 2025 U.S. Benchmark Policy Guidelines
- The U.S. Securities and Exchange Commission adopting EDGAR Next, which overhauls filer access and account management
- The Public Company Accounting Oversight Board pausing Non-Compliance with Laws and Regulations rulemaking, which was scheduled to be finalized by the end of the year
- The SEC charging an independent director with disclosure failures related to a personal relationship
- The SEC charging the audit committee chair of AI company with failing to adequately investigate a report of financial misdeeds and signing a Form 10-K containing fake revenue

## Important Reminders

- Beginning December 18, Schedules 13D and 13G must be filed using an XML-based language. This structured data requirement applies to all disclosures (other than exhibits), including all quantitative disclosures, textual narratives and identification checkboxes. Filers will have the option of (1) using a fillable web form that converts inputted disclosures into 13D/13G-specific XML or (2) submit filings directly in 13D/G-specific XML format. Filers submitting filings directly in 13D/G-specific XML format may need to involve a financial printer, which could increase the time and costs of compliance. Issuers and filers should be aware that this structured data requirement will make the information easier for the public to access and analyze. For more information, please see our client alert and the SEC's final rule.
- New requirements and reminders for upcoming Annual Reports on Form 10-K (FY2024):
    - Insider Trading: Disclosure of insider trading policies and procedures required for companies, including smaller reporting companies (SRCs). A company can incorporate by reference in its Form 10-K the information required under Item 408(b) from a definitive proxy statement if the proxy statement is filed within 120 days of the end of the fiscal year. See Item 408(b)(1), C&DI 120.26, and our client alert.
    - Insider Trading: Insider trading policies must be filed as an Exhibit 19 by all companies. See Item 408(b)(2), C&DI 120.26, and our client alert.

- **Insider Trading:** Narrative disclosure of certain equity award practices is required for companies, including SRCs. A company can incorporate by reference in its Form 10-K the information required under Item 402(x) from a definitive proxy statement if the proxy statement is filed within 120 days of the end of the fiscal year. See Item 402(x), C&DI 120.26, and our client alert.
- **Insider Trading:** Tabular disclosure of certain equity awards granted in close proximity to the release of material non-public information is required for companies, including SRCs. A company can incorporate by reference in its Form 10-K the information required under Item 402(x) from a definitive proxy statement if the proxy statement is filed within 120 days of the end of the fiscal year. See Item 402(x), C&DI 120.26 and our client alert.
- **Clawback Checkboxes:** Reminder to include the following checkboxes on the Form 10-K and confirm if either event has occurred:
    - If securities are registered pursuant to Section 12(b) of the Act, indicate by check mark whether the financial statements of the registrant included in the filing reflect the correction of an error to previously issued financial statements.
        - According to recent SEC guidance, this first checkbox generally applies to all corrections, including "Big R" restatements, "little r" restatements, and voluntary restatements.
        - Jessica Barberich, Assistant Chief Accountant in Corp Fin, provided the following example: "If the error is immaterial to the prior year and correction in the current year would also be immaterial, the company is permitted to correct the financials through an out-of-period adjustment to the current year, and the company isn't required to restate the prior year. If the company chooses to correct the error via a restatement of the prior year, it will need to check the box. If the company instead uses an out-of-period adjustment to the current year, it does not need to check the box, because it hasn't revised previously issued financial statements." Clawbacks: Common Questions on Form 10-K Checkboxes (CompensationStandards.com, April 2024).
    - Indicate by check mark whether any of those error corrections are restatements that required a recovery analysis of incentive-based compensation received by any of the registrant's executive officers during the relevant recovery period pursuant to §240.10D-1(b).
        - According to recent SEC guidance, this check box should be marked for all "Big R" restatements and "little r" restatements, even if the company concludes that no recovery was actually required.
- **Cybersecurity**: In 2024, the SEC Staff selectively reviewed Form 10-K cybersecurity disclosure as part of its annual review process and have issued a number of comments on the new disclosure. Initial comments primarily focused on inconsistent disclosures, not fully addressing the disclosure requirements, or in some cases, forgetting to include the required disclosures altogether. The areas that the SEC focused on in these comments were:

- Whether and how the company has integrated processes for assessing, identifying, and managing material risks from cybersecurity threats into the overall risk management system or processes
- Whether the company engages assessors, consultants, auditors, or other third parties in connection with its processes for assessing, identifying, and managing material risks from cybersecurity threats
- The relevant expertise of members of management involved in assessing and managing the company's material risks from cybersecurity threats

Recent SEC Staff commentary has also warned against boilerplate disclosure. Companies should consider these comment letter trends and recent guidance when updating cybersecurity disclosures this year.

- Artificial Intelligence: Consider whether disclosure about how a company uses artificial intelligence and the related risks is required. Based on recent SEC Staff commentary, the SEC expects companies to:
  - Clearly define artificial intelligence
  - Explain how they are actually using artificial intelligence
  - Explain how they are managing artificial intelligence risks
  - Have a reasonable basis for any claims about artificial intelligence prospects
- XBRL Tagging: Insider trading and cybersecurity disclosures must now be XBRL tagged, including for SRCs.

- New requirements and reminders for upcoming 2025 Proxy Statements:
  - Insider Trading: Disclosure for insider trading policies and procedures required for all companies, including SRCs. See Item 408(b)(1), C&DI 120.27, and our client alert.
  - Insider Trading: Narrative disclosure of certain equity award practices is required for companies, including SRCs. See Item 402(x), C&DI 120.27, and our client alert.
    - Examples: Peloton, P&G, H&R Block, Parker-Hannifin Corp
  - Insider Trading: Tabular disclosure of certain equity awards granted in close proximity to the release of material non-public information is required for companies, including SRCs. See Item 402(x), C&DI 120.27, and our client alert.
    - Examples: Vail Resorts, Worthington Enterprises
  - Pay vs. Performance: As part of the phase-in, companies are required to provide pay versus performance disclosure for an additional year (i.e., 4 years for SRCs and 5 years for all other companies now). See Item 402(v).

- **Clawback**: Disclosure is required if during or after its last completed fiscal year a company either (1) a triggering restatement occurs or (2) there remains an outstanding balance of compensation subject to clawback that relates to a prior year's restatement. If a company conducted a recovery analysis and concluded that a recovery was not required under its clawback policy, under Item 402(w)(2), the company must still disclose the restatement and explain the basis for concluding that no recovery was required. In other words, check your Form 10-K cover page. If the first clawback checkbox is marked, disclosure will be triggered in the proxy statement. See Item 402(w) and our client alert.
    - Examples of clawback disclosures in proxy statements: NCR Voyix, Graham Holdings, Cardinal Health, Teva Pharmaceuticals
- **Universal Proxy Card**: Disclosure of the deadline for providing notice of a solicitation of proxies in support of director nominees other than the company's nominees for the next annual meeting. See Item 1(c), Schedule 14A.
- **Universal Proxy Card:** Confirm correct voting choices on proxy card for director elections depending on whether a majority or plurality voting standard applies. See Rule 14a-4(b)(4).
- **Nasdaq Diversity Matrix**: For Nasdaq-listed companies, disclosure of aggregated board diversity data in a board diversity matrix for both the current and immediately prior year. See Nasdaq Rule 5606, board diversity matrix instructions and templates (available here), board diversity disclosure requirements and examples (available here), and FAQs on board diversity disclosure (available here).
- **Nasdaq Diversity Disclosure**: Nasdaq-listed companies are required to either have one diverse director on their board or explain why they do not in the proxy statements. Looking forward, companies listed on The Nasdaq Global Select Market or The Nasdaq Global Market must have, or explain why they do not have, at least two diverse directors by December 31, 2025, or two years from listing, whichever date is later. See Nasdaq 5605(f) and Nasdaq's Board Diversity Rule Transition Guidance (available here).
- **Board Leadership and Risk Oversight Disclosure**: In 2023, the SEC was carefully reviewing disclosures relating to board leadership structure and the board's role in risk oversight and issuing comment letters requesting expanded disclosure in future filings. See Item 407(h).
- **Cybersecurity**: To the extent cybersecurity risks are material to a company's business, the SEC believes the Board Leadership and Risk Oversight Disclosure required under Item 407(h) should include the nature of the board's role in overseeing the management of that risk. See the SEC's 2018 Statement and Guidance on Public Company Cybersecurity Disclosure and Item 407(h).
- In the Cybersecurity Final Rule, the SEC explained "that *Item 407(h) and Item 106(c)(1) as adopted serve distinct purposes and should not be combined*, as suggested by some commenters—the former requires description of the board's leadership structure and administration of risk oversight generally, while the latter requires detail of the board's oversight of specific cybersecurity risk. As noted by one commenter, *to the extent these disclosures are duplicative, a registrant would be able to incorporate such information by reference*."

- XBRL Tagging: Pay versus performance, insider trading and clawback (if any) must now be XBRL tagged. See PvP XBRL: Is Someone Checking the Math? (*theCorporateCounsel.net*, May 2024).
- General Reminder: Given that some topics are increasingly required to be discussed in more than one SEC filing, location, or context, reminder that disclosures should be consistent with each other and that the discussions of policies, charters, and procedures were consistent with company's conduct.

## Rules and Regulations

- Glass Lewis releases its 2025 Proxy Voting Policy Guidelines 2025 U.S. Benchmark Policy Guidelines, including guidelines for shareholder proposals and ESG-related issues. The guidelines for the U.S. include added or updated sections on board oversight of artificial intelligence, board responsiveness to shareholder proposals, and change-in-control provisions for executive compensation. They also include clarifications to Glass Lewis' policy approach on reincorporation proposals and executive pay programs. For a summary of the changes, please see our client alert.
- SEC adopts EDGAR Next overhauling filer access and account management. The SEC has adopted a final rule updating the rules governing access to and the management of accounts with the SEC's EDGAR system, including introducing multifactor authentication to the system, requiring filers to authorize individuals to utilize their EDGAR accounts via a new dashboard, and adding optional application programming interfaces (APIs). Compliance with the new process known as EDGAR Next will be phased in between March 24, 2025, and December 22, 2025. Please see key compliance dates below:

| Compliance Dates | Transition Items |
|---|---|
| March 24, 2025 | • The new dashboard for managing access goes live and filers can begin enrollment and connect to APIs.<br>• Amended Form ID required.<br>• Form IDs must be submitted through the new dashboard.<br>• Existing filers can still submit filings using the legacy process. |
| March 24, 2025 – Sept. 12, 2025 | • Existing filers can still submit filings using legacy process until September 12.<br>• New filers must use amended Form ID to obtain access to EDGAR. |
| Sept. 15, 2025 | • Compliance with all rule and form changes required. |
| Sept. 15, 2025 – Dec. 19, 2025 | • Existing filers must enroll on EDGAR Next dashboard to make a filing. |
| Dec. 22, 2025 | • Filers that have not enrolled in EDGAR Next will be required to submit amended Form ID to request access to their existing accounts. |

For more information, please see the SEC's final rule, fact sheet and blackline copy of the EDGAR filer manual.

- **PCAOB pauses NOCLAR rulemaking,** which was scheduled to be finalized by the end of the year. PCAOB previously proposed a controversial amendment to its auditing standards to increase the auditor's obligations to more proactively identify, evaluate and communicate instances of a company's non-compliance with laws and regulations (referred to as "NOCLAR"). According to Accounting Today, PCAOB currently plans to take no further action until further consultation with the SEC under the incoming administration. See PCAOB Pauses NOCLAR (theCorporateCounsel.net, November 2024).

- **SEC approves Nasdaq rule change to modify bid price compliance periods.** On October 7, the SEC approved Nasdaq's proposal to amend Rule 5810(c)(3)(A) to modify the application of bid price compliance periods. This amendment addresses situations where a listed company takes action to meet the $1.00 minimum bid price continued listing requirement (bid price requirement), but that action results in non-compliance with another listing requirement. For instance, if a company uses a reverse stock split to regain compliance with the minimum bid price requirement and this action causes the company to fall below the minimum number of publicly held shares and holders required by Nasdaq standards, the company will not receive additional time to rectify the new violation.

- **NYSE proposes rule change to limit reverse stock splits for compliance with price criteria.** On October 10, the SEC published a notice of a NYSE proposal that aims to make it more difficult for penny stocks to maintain their listing status. According to rule 802.01C, a company will be deemed non-compliant if the average closing price of its security, as reported on the consolidated tape, is below $1.00 for a consecutive 30-trading-day period (the "Price Criteria"). The proposed NYSE rule states:

> "Notwithstanding the foregoing, if a company's security fails to meet the Price Criteria and the company (i) has conducted a reverse stock split within the past year or (ii) has conducted one or more reverse stock splits within the past two years with a cumulative ratio of 200 shares or more to one, then the company will not be eligible for any compliance period specified in Section 802.01C. The Exchange will immediately initiate suspension and delisting procedures for such security in accordance with Section 804.00. Additionally, a listed company may not carry out a reverse stock split if doing so would result in the company's security falling below the continued listing requirements of Section 802.01A."

## SEC Public Commentary and Guidance

- **SEC Enforcement Division Acting Director reviews 2024 enforcement priorities and trends at Securities Enforcement Forum D.C. 2024.** In his recent remarks before the Securities Enforcement Forum D.C. 2024, Acting Enforcement Director Sanjay Wadhwa discussed the SEC's enforcement activities over the past year, focusing on the following three areas:

    - **Cooperation with SEC Investigations:** The SEC continues to emphasize the benefits of cooperating with the SEC. Acting Director Wadhwa noted that in 2024, the public companies, investment advisers, broker-dealers, and individuals received reduced penalties for cooperation in matters involving a range of violations, such as material misstatements, fraud, recordkeeping violations, and control failures. Notably, in recognition of their cooperation, all but two of the entities received no civil penalties and the remaining two (R.R. Donnelley & Sons and JP Morgan) received significantly lower penalties.

- **Off-Channel Communications Initiative:** The SEC's ongoing off-channel communications initiative (the "WhatsApp Initiative") aims "ensure that regulated entities, including broker-dealers, investment advisers, and credit rating agencies, comply with recordkeeping requirements of the federal securities laws." In 2024, the SEC brought recordkeeping cases resulting in over $600 million in civil penalties against more than 70 firms. Notably, all of the firms admitted that their conduct violated the recordkeeping requirements as part of their settlement agreements, which is atypical.

- **Whistleblower Protection Sweep:** In September, the SEC charged seven public companies with violating whistleblower protection Rule 21F-17(a). In his remarks, Acting Director Wadhwa noted that SEC brought a series of similar actions several years ago, but noticed that compliance had slipped again recently. In particular, he flagged that confidentiality agreements and employment agreements continue to limit individuals' ability to voluntarily contact the SEC or to require employees to waive the right to a monetary award from a whistleblower program.

  As a reminder, companies should review their employment and separation agreements along with related policies for provisions requiring employees to waive their right to whistleblower awards or requiring notice of whistleblower communications to agencies.

- **The Department of Justice updates its Evaluation of Corporate Compliance Programs (ECCP).** In September, the DOJ announced its updated Evaluation of Corporate Compliance Programs guidance, which is the roadmap that Criminal Division prosecutors use to evaluate a company's compliance program. The updated guidance underscores two primary DOJ priorities for corporate compliance: (1) how companies are navigating risks relating to artificial intelligence and other "new and emerging technologies," and (2) how companies are encouraging and protecting corporate whistleblowers. Please see our client alert for more information.

  As public companies gear up for their annual review of corporate policies and employee training, corporate attorneys may want to particularly focus on the following guidance from the ECCP:

  - **Design:** Companies should have a process for updating policies and procedures, including updates to reflect lessons learned either from the company's own prior issues or from those of other companies. As part of this process, attorneys reviewing policies and procedures should consult business units and other key stakeholders in the company prior to rolling out any changes.

  - **Accessibility:** The ECCP indicates that companies are expected to (1) translate their policies and procedures to another language for foreign subsidiaries, (2) publish policies and procedures in *searchable* format, (3) confirm that employees know how to access relevant policies, and (4) track access to various policies and procedures to understand what policies are attracting more attention from relevant employees. These are relatively simple changes to bolster a company's compliance program.

  - **Gatekeepers:** Companies should provide tailored guidance and training to employees with approval authority or certification responsibilities for control processes, so they understand what misconduct to look for and how to escalate concerns. For example, do leaders on the company's sales team understand what type of gifts, entertainment, or other expenses are prohibited under the anti-corruption policy and should not be approved?

- **Training:** Companies should provide regular compliance training to employees. These trainings should be updated to reflect lessons learned either from the company's own prior issues or from those of other companies. The ECCP suggests that companies should evaluate employee engagement with training and whether they have learned the covered subject matter. For example, companies may want to consider including a test and addressing employees who fail all or a portion of the testing.
- **Guidance re: Policies:** The ECCP suggests that companies should provide guidance regarding compliance policies. Corporate teams may want to keep track of common employee questions about certain policies and prepare a plain-English FAQ covering these topics.

- **The SEC Office of Inspector General (OIG) is auditing the SEC's rule-making processes and internal controls.** The OIG expects to complete its audit report in FY 2025. See Inspector General's Statement on the SEC's Management and Performance Challenges (U.S. Securities and Exchange Commission Office of Inspector General, 2024).

## Relevant Litigation and Enforcement Actions

- **The SEC charged an independent director with disclosure failures related to a personal relationship.** The SEC settled charges against a former CEO, chairman, and director for violating proxy disclosure rules by standing for election as an independent director without disclosing his close personal friendship with a company executive, resulting in materially misleading statements in the company's proxy statement.

  Among other things, the director concealed that he frequently vacationed with the executive and his spouse. Directors should be careful to disclose all relationships that could interfere with exercising his or her independent judgment, including personal relationships.

- **The SEC charged the audit committee chair of an AI company with failing to adequately investigate a report of financial misdeeds and signing a Form 10-K containing fake revenue.** The SEC filed civil charges against the former audit committee chair of an AI company for their alleged role in inflating and misstating the company's revenue in two public stock offerings.

  While the director did not spearhead the fraud, he allegedly failed to adequately investigate it after an employee raised the issue, and to correct false and misleading statements made ahead of an offering. The director was also subject to liability by signing relevant SEC filings. For more information, please see our client alert.

  Directors who are aware of serious reports of misconduct must ensure that the company is responding appropriately and should be careful not to shield relevant information from the company's independent financial auditors.

- **The Delaware Court of Chancery held that only a majority vote of all outstanding shares was required to approve Trade Desk's proposed reincorporation from Delaware to Nevada.** In *Gunderson v. The Trade Desk Inc.*, the stockholder-plaintiff argued that a supermajority vote was required because Article X of the company's charter requires a supermajority vote for the amendment or repeal of the charter, and the conversion would result in the amendment or repeal of the charter.

The court determined that Article X did not apply because the language of Article X does not explicitly specify that the supermajority vote requirement extends to amendments or repeals resulting from a corporate conversion. See Del. Dispatch: Clarifying Charter Amendment Vote Obligations (*Law360*, November 2024).

In an appendix to Trade Desk's proxy statement relating to the conversion, Trade Desk provided a table of proxy filings by Delaware corporations that have recently proposed reincorporation (attached above). The table indicates that from January 1, 2021, to August 19, 2024, 18 Delaware corporations proposed to reincorporate to other states. Of those 18 Delaware corporations, 14 proposed reincorporation to Nevada and two to Texas.

According to *Law360*, only eight of the 18 Delaware corporations that proposed to reincorporate have actually reincorporated to new states. All eight of these corporations appear to be controlled companies. Id.

- The Fifth Circuit rejected a challenge to SEC Rule 14a-8 no-action letters. On November 14, the Fifth Circuit Court of Appeals dismissed an appeal by conservative advocacy group, the National Center for Public Policy Research, which sought to vacate a no-action letter the SEC sent to Kroger Company about a shareholder proposal the center had submitted.

  The Fifth Circuit panel held that the court lacked subject matter jurisdiction over the challenged no-action letter because the letter was issued by the SEC merely as guidance and did not constitute an official expression of the SEC's views. For more information, see our client alert here.

## Disclosure Trends – Amended Form 10-K Filings

- Form 10-K/A Filing Trends: The Deep Quarry blog recently examined the reasons for amendments to Form 10-K filings between July 1, 2024, and September 30, 2024:

**Table 1 - Reasons for amended 10-Ks**

| Reason | Count | % |
|---|---|---|
| Audit opinion or consent updates | 40 | 27% |
| Restatements & error corrections | 36 | 24% |
| Section 302 or 906 management certifications | 19 | 13% |
| Disclosure or internal control issues | 16 | 11% |
| Exhibits - missing or updated | 15 | 10% |
| Cover page disclosure issues | 6 | 4% |
| Missing cybersecurity disclosure | 3 | 2% |
| Updates to compensation recovery policy | 1 | 1% |
| Proxy/Part III incorporation by reference | 16 | 11% |

Source: 10-K/A filings, analysis by DeepQuary
* Note: the categories are not mutually exclusive, so the total percentage could exceed 100%

## Notable Resources

- 2024/2025 EDGAR Calendar – Federal Holidays and Peak Filings Dates

This update was created by Fenwick's corporate governance and capital markets practices.

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As a leading technology and life sciences law firm, Fenwick advises companies on the full suite of corporate governance matters. We partner with our clients to anticipate and navigate issues arising in an evolving corporate governance landscape, including SEC reporting and governance requirements of relevant securities exchanges, board and committee structure, corporate purpose and sustainability, shareholder engagement, and executive compensation.