Securities Law Update—June 2024

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Welcome to the latest edition of Fenwick's Securities Law Update. This issue contains news on:

- **Rules and regulations** covering proposed changes to Nasdaq and SEC rules, as well as an overview on Colorado's new "high-risk" AI legislation.
- **SEC public commentary and guidance** issued during Securities Enforcement Forum West 2024 and the SEC Chair's statement on new crypto legislation recently passed by the House of Representatives.
- **Recent litigation**, including proceedings against the Intercontinental Exchange, Inc. and updates on climate disclosure rules and Exxon Mobil's board vote that came against a backdrop of litigation against an activist investor.
- **Proxy season trends**, including say-on-pay, shareholder proposals, director election results, and no-action letter trends.
- **Disclosure trends** covering public companies' diversity disclosures.

Rules and Regulations

- **Nasdaq proposes modifying independent director & committee phase-in.** Nasdaq has proposed changes to Rules 5605, 5615, and 5810 to clarify and modify the phase-in schedules to the independent director and committee requirements for companies in various circumstances—including those listing in connection with IPOs, emerging from bankruptcy, transferring from other national securities exchanges, with securities previously registered under Section 12(g) of the '34 Act, listing in connection with a carve-out or spin-off transaction, and ceasing to qualify as a foreign private issuer—and to codify its existing position on eligibility for cure periods in certain circumstances. See "Nasdaq Proposes Phase-in and Cure Period Changes and Clarifications" (*theCorporateCounsel.net*, May 2024).
- **On May 17, 2024, Gov. Jared Polis signed the Colorado Artificial Intelligence Act (CAIA), regulating the development, deployment, and use of artificial intelligence systems.** CAIA will generally apply to developers and deployers of "high risk AI systems," which are defined as AI systems that make, or are a substantial factor in making, a "consequential decision." For these developers and deployers, CAIA imposes a duty of reasonable care to avoid "algorithmic discrimination" in high-risk AI systems. If a

developer or deployer complies with the disclosure, risk assessment, and governance requirements in the statute, there will be a rebuttable presumption that the developer or deployer has used reasonable care to avoid algorithmic discrimination. Most requirements under CAIA do not apply to general-purpose AI systems, which are not considered high-risk AI systems. The only requirement for these types of non-high-risk AI systems is a requirement to transparently disclose the use of AI.

CAIA does not provide a private right of action for consumers and will be exclusively enforced by the Colorado attorney general or district attorneys. For the purposes of enforcement, violations of the CAIA will be treated as unfair or deceptive trade practices in accordance with the Colorado Consumer Protection Act. See "Colorado AI Law Catapults AG Weiser to National Policy Influence" (*Bloomberg*, May 2024, subscription required).

CAIA will become effective February 1, 2026. Colorado is the first state to enact comprehensive AI legislation, but several other states are considering AI legislation, and the European Union is expected to adopt the EU AI Act in the coming weeks. These new legislative initiatives will add challenges as companies seek to develop a global compliance framework.

Companies may want to review their AI risk factors in their upcoming Form 10-Q and consider whether any updates are necessary for the EU AI Act, CAIA, or other potential state legislation.

- **On May 22, 2024, the SEC published a notice of designation extending the period for Commission action on a proposed rule change to amend Section 102.06 of the NYSE Listed Company Manual regarding SPACs.** As you may recall, the SEC published a notice and comment request for a proposed NYSE rule to amend Section 102.06 of the NYSE Listed Company Manual, so SPACs can remain listed until 42 months after the original listing date if they entered into a business combination agreement within three years of listing. After receiving no comments on the proposed rule change, the SEC extended the period to take action on the proposed rule change to July 9, 2024, so that it has sufficient time to consider it.
- **Tagging errors rampant on pay vs. performance disclosure.** An analysis of pay versus performance disclosures by Toppan Merrill identified the most common data tagging errors:
  1. Inline eXtensible Business Reporting Language (XBRL) tagging errors in the adjustments from the "Executive Compensation Amount" to the "Amount Actually Paid"
  2. Incorrectly tagging the names of the principal executive officer and named executive officers with the same element.

  With the increasing market usage of XBRL data and the SEC's focus on such data, it is important that companies tag their information accurately so the data can be consumed and analyzed without issue.

SEC Public Commentary and Guidance

- SEC Enforcement Division director promotes cooperation at Securities Enforcement Forum West 2024. In his recent remarks before the Securities Enforcement Forum West 2024, Enforcement Director Gurbir Grewal explained how and why cooperation with an SEC investigation typically benefits the efficiency of the process (subject to specific facts and circumstances)—as well as the parties involved

in the form of reduced charges and penalties. He shared his views on principles that the Division considers when evaluating companies' cooperation:

1. *Self-Policing* – Grewal noted that the best cooperation starts early and well before the SEC gets involved, with self-policing. When thinking about self-policing, he asks: "Are the leaders in an organization supporting a culture of compliance? Are they emphasizing both the need to stay within the lines and the importance of doing so? In other words, are they walking the walk? And importantly, are they supporting the compliance function through their words, actions, and with resources?"
2. *Self-Reporting* – Grewal emphasized that once companies discover a possible violation, they should self-report without delay. He commented: "When we get that call from an entity indicating to us that they think they may have a problem, are starting to look into it, and will report back, it signals a number of things. It signals, for one, effective self-policing. It also signals a culture of proactive compliance. And it helps build credibility with the staff for when issues may arise in the future." Conversely, he noted that a failure to self-report could "raise questions about their supervisory systems and compliance function."
3. *Remediation* – Grewal stated that "[e]ffective remediation can further underscore a firm's commitment to compliance and help them build a case for cooperation credit." Remediations efforts may include "disciplining or dismissing the actors responsible for the violations; strengthening relevant internal controls and policies and procedures; conducting training—or re-training—on the conduct at issue; hiring personnel with relevant expertise; clawing back or recovering certain executive compensation; and repaying harmed investors."

   Grewal clarified that even if a company doesn't self-report, it can still earn meaningful cooperation credit by conducting a comprehensive internal investigation, remediating the violations, repaying harmed investors, and improving its compliance function.
4. *Cooperation* – Grewal stated the type of cooperation that earns credit requires going above and beyond what's legally required—more than simply complying with subpoenas without undue delay or gamesmanship. He recommended that, after receiving a request, company counsel connect with the enforcement team to discuss what kinds of documents may contain responsive material, how responsive items are maintained, and how voluminous the records are. Companies can also help identify who the SEC should speak with to get necessary information and coordinate interviews or testimonies.

   Further, when producing documents, companies can earn meaningful cooperation credit by flagging and offering to explain hot documents and how they fit into the larger picture, and offering to translate responsive documents that are in a language other than English.
5. *Collaboration* – Grewal emphasized that companies should "collaborate with enforcement staff early, often, and substantively." Collaboration provides companies an opportunity to establish credibility with the staff.

These principles are further outlined in the Division's Enforcement Manual (p98).

- **SEC chair makes statement on crypto legislation.** On May 22, 2024, SEC Chair Gary Gensler issued a statement criticizing crypto legislation recently passed by the House of Representatives. The Financial Innovation and Technology for the 21st Century Act seeks to modernize regulation by creating three new categories of digital assets (restricted digital asset, digital commodity, and permitted payment stablecoin), which would determine whether a digital asset falls under SEC or Commodity Futures Trading Commission jurisdiction. Gensler believes the legislation would "create new regulatory gaps and undermine decades of precedent regarding the oversight of investment contracts, putting investors and capital markets at immeasurable risk." See "Digital Assets Legislation: Where Do We Go From Here?" (*theCorporateCounsel.net*, June 2024) and "Gensler Slams Crypto After House Passes Bill Opening Regulatory Gaps" (*CFO Dive*, May 2024).

Relevant Litigation

- **The SEC confirmed there will be a new implementation period provided for the climate disclosure rules.** In a court filing related to the challenge of the SEC's climate disclosure rules in the Eight Circuit, the SEC stated that it will publish a document in the Federal Register at the conclusion of the stay of the rules addressing a new effective date for implementation. See "SEC Climate Disclosure Rules: New Effective Date to be Provided" (*theCorporateCounsel.net*, May 2024). While the SEC has not specified the duration of the further implementation period if the climate rules survive the litigation, it has confirmed that a new implementation period will be provided.

  As previously noted, the SEC stayed the effectiveness of the new rules pending completion of judicial review in the Eighth Circuit. The current briefing schedule suggests that the climate disclosure rules will likely not become effective this year.

- **On May 22, 2024, the SEC announced proceedings against the Intercontinental Exchange, Inc. and nine affiliates** (collectively, ICE), including the NYSE, for failing to notify the SEC about a cyber intrusion as required by Regulation SCI. The settlement included a $10 million civil penalty. See "Enforcement: NYSE and Other Intermediaries Dinged for Ultimately De Minimis Cyber Intrusion" (*theCorporateCounsel.net*, May 2024).

  "Under Reg SCI, [intermediaries] have to immediately notify the SEC of cyber intrusions into relevant systems that they cannot reasonably estimate to be de minimis events right away," Grewal said. "[T]hey instead took four days to assess its impact and internally conclude it was a de minimis event. When it comes to cybersecurity, especially events at critical market intermediaries, every second counts and four days can be an eternity."

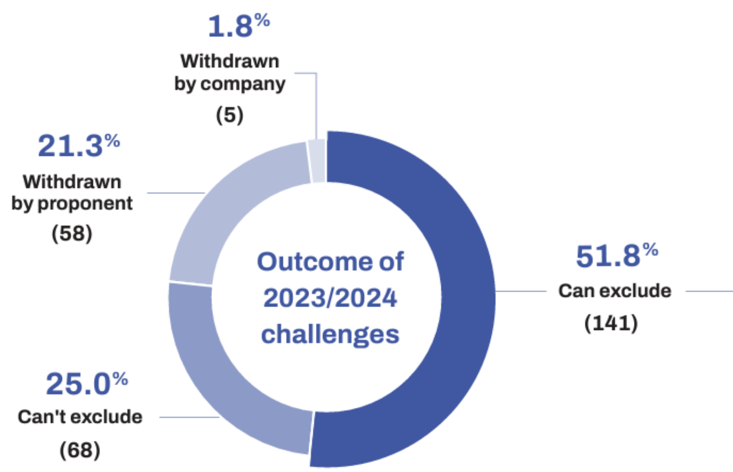
  Commissioners Hester Peirce and Mark Uyeda issued a joint statement arguing that the penalty was "disproportionately large" given that ICE ultimately determined the incident was de minimis. The Commissioners believe that "[i]mposing outsized penalties for minor violations risks creating a counter-productive dynamic between the Commission and regulated entities."

- **On May 29, 2024, Exxon Mobil's board of directors was re-elected at its 2024 annual shareholder meeting** with an average of 95.2% of the votes cast for its board nominees—despite controversy over the company's lawsuit against an activist investor. Exxon Mobil filed a lawsuit against Arjuna Capital, LLC and Follow This, the two proponents of a climate-related shareholder proposal, seeking a declaratory judgment that it may exclude their proposal from its 2024 annual meeting proxy statement. Although the proponents withdrew their proposal, Exxon decided not to withdraw its complaint. In response, Glass Lewis recommended against Exxon's lead independent director and several institutional investors filed notices of exempt solicitations or otherwise indicated that they would vote against Exxon's board of directors. See "Shareholder Proposals: More Reaction to Exxon's Approach" (*theCorporateCounsel.net*, May 2024, subscription required).

Proxy Season Trends

- **Say-on-pay.** As of May 30, 2024, average say-on-pay support for Russell 3000 companies is 91.6% this year—with nine failures so far—which is trending 50 basis points higher than average support at this time last year and the highest in any single year since 2017. See "2024 Say on Pay Reports (Volume 5)" (*Semler Brossy*, May 2024).
- **Shareholder Proposals.** As of the week of May 31, 2024, average support for shareholder proposals was 24%, approximately 1% lower than this same time last year. According to Proxy Analytics, "[s]upport for shareholder resolutions continues to be bolstered by a considerable increase in support for governance resolutions, which currently sits at an average of 41%, up 10% from last year." Since July 2023, "41 shareholder proposals that have received majority support, up from 32 at the same time last year. The vast majority of these pertain to traditional governance initiatives like eliminating supermajority voting requirements (27) and shareholder ability to call a special meeting (5)." See "Weekly Wrap Up" (*Proxy Analytics*, May 31, 2024).
- **Novel shareholder proposals.** Please note the following novel shareholder proposal trends:
  1. *Say-on-director-pay* – A shareholder proposal for "Double Binding Director Say-on-Pay" has been submitted to 13 companies. The Corporate Counsel notes that "[t]he proposal is unique because it's structured as a binding bylaw amendment (rather than a precatory request). If approved, director pay would be subject to an annual, binding vote." See "Say-on-Director-Pay: 'Double Binding' Bylaw Proposals on the Ballot," (*theCorporateCounsel.net*, May 2024, subscription required).
  2. *Conflict minerals* – A shareholder proposal seeking to expand conflict minerals due diligence has been submitted to two companies. Historically, conflict-affected and high-risk areas issues have not been included in shareholder proposals and instead have been addressed through laws, regulations, and related initiatives, including the SEC conflict minerals rule. See "Shareholders Seek to Expand Conflict Minerals Due Diligence" (*practicalESG.com*, May 2024).
- **Director election results.** As of May 30, 2024, average vote support for director nominees was 95.7% year to date, which is 90 basis points higher than the year-end support observed in 2023. See "2024 Say On Pay + Proxy Vote Results (Volume 5)" (*Semler Brossy*, May 2024).

- **No-action letter trends.** The number of no-action requests for the 2023/24 season (276) increased 50% compared to the prior 2022/23 season (184). However, no-action request grants are also up 6 percentage points this season (52%) compared to the 2022/23 season (46%). Notably, exclusions under Rule 14a-8(i)(2) (violation of law) and Rule 14a-8(i)(7) (ordinary business) increased significantly season-over-season, with the latter representing 40% of all exclusions. Please see a full analysis of the exclusions granted this season compared to last season below:



Procedural	**39**	**27.7%**
(i)(2)	22	15.6%
(i)(3)	0	0.0%
(i)(4)	1	0.7%
(i)(6)	1	0.7%
(i)(7)	58	41.1%
(i)(8)	1	0.7%
(i)(10)	10	7.1%
(i)(11)	3	2.1%
(i)(12)	6	5.0%
(i)(13)	0	0.0%
Can exclude	**141**	**100.0%**

(Source: Harvard Law School Forum on Corporate Governance)

See "Season-end Summary of Challenges under Rule 14a-8" (*Harvard Law School Forum on Corporate Governance*, May 2024).

Disclosure Trends - DEI

- **Public companies adjusting Diversity Equity and Inclusion (DEI) disclosure in response to litigation risk.** Fortune 100 companies are changing how they use particular DEI-related terminology year-over-year, according to a widely republished report by Fortune based on analysis of public disclosures. See "DEI Disclosure Terminology Trends" (*Society of Corporate Governance*, June 2024) citing "How the 100 Biggest U.S. Companies Have Changed their DEI Messaging" (*Fortune*, May 2024).

	Directional change in use from 2023
Charged terms like "DEI"; "diversity"; inclusion	-22%
More neutral terms such as "belonging"; "diverse experiences"; "diverse perspectives"	+59%
Explicit mentions of diversity-focused executive positions like "chief diversity officer"; "representation targets"; and "supplier diversity programs"	-
"Diversity officer"	-49%
References to diversity-focused programs or terms like "representation goal"	-52%
"underrepresented"	-
Generalized terms such as "our people"; "talent"; "culture"	+

(Source: Society for Corporate Governance)

In March 2024, *Bloomberg* reported (subscription required) that of 82 Form 10-Ks reviewed, about 20% of companies either tweaked or removed their DEI-related language compared to their two previous filings, seemingly to mitigate litigation risk and to reflect associated risk-mitigating changes in practices following the Supreme Court's college admissions affirmative action decisions last year, rather than as a result of a shift in their commitments to diversity. See "Form 10-K DE&I Disclosures Tweaked in Response to Litigation Risk" (*Society of Corporate Governance*, March 2024) citing "Uber and Citi Cut 'Anti-Racist" From Corporate Vocabulary Following DEI Backlash" (*Bloomberg*, March 2024).

Bloomberg Law also reported (subscription required) that, between the Supreme Court's decision and March 8, 2024, an increasing number of companies are characterizing their DEI or similar initiatives as a risk factor in their Form 10-Ks. Such risk factors address the political backlash against DEI, legal risks, reputational risks, hiring and retention challenges, and other potential adverse implications. Companies identified in the article with DEI risk factor disclosures include JetBlue, Molson Coors Beverage Company, Leidos, Duolingo, KKR & Co., Jones Lang Lasalle, Twilio, Blue Owl Capital Corp., TPG Inc., Synonvus Financial Corp., iHeartMedia, and Ares Management. See "DEI-Related Risk Factors Trending Up" (*Society of Corporate Governance*, March 2024) citing "Firms From KKR to Coors Flag DEI as Business, Legal Risk" (*Bloomberg Law*, March 2024).