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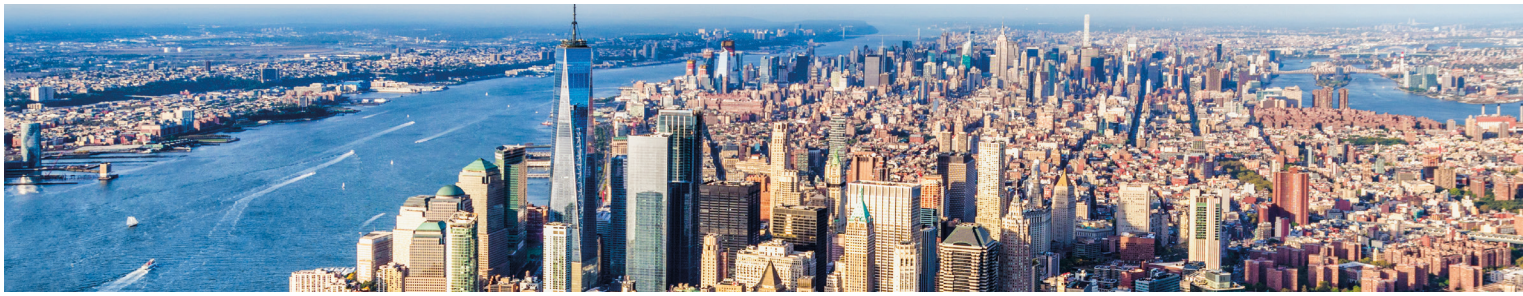
SEC Transactions and Compliance ("STAC") Group

Quarterly SEC Round-Up – Q4 2023



Climate change disclosure rules in spring 2024?

The SEC has pushed back adoption of its long-awaited climate change disclosure rules to spring 2024, according to its most recent regulatory agenda. The agenda does not contemplate any re-proposal of the climate change disclosure rules.

The agenda also indicates that the SEC has pushed back to spring 2024 the adoption of its rules related to SPACs, ESG disclosure rules for funds, and the publication of proposals regarding human capital management disclosure and Regulation D amendments. Among the key dates set out in the agenda are:

- Climate change disclosure rules – adoption expected in April 2024.
- SPAC rules – adoption expected in April 2024.
- Rule 14a-8 amendments – adoption expected in April 2024.
- Fund ESG disclosure rules – adoption expected in April 2024.
- Human capital management disclosure – proposal expected in April 2024.
- Corporate board diversity disclosure – proposal expected in October 2024.
- Section 12(g) "held of record" definition amendments – proposal expected in April 2024.
- Regulation D amendments – proposal expected in April 2024.
- Rule 144 holding period amendments – re-proposal expected in October 2024.
- Resource extraction payment disclosure – re-proposal expected in October 2024.

Key takeaway – While important in establishing the SEC's priorities, the rulemaking agenda does not mean that the climate change disclosure rules will definitely be adopted in April 2024. The agenda, which is published twice a year, is not binding on the SEC, and it is not uncommon for the SEC to deviate from it. In fact, the climate change disclosure rules were originally scheduled to be adopted in October 2022 and have been included in all the rulemaking agendas since they were proposed. Registrants should continue to assess the potential impact of the proposed rules upon their operations. However, it is important to note that the rules as adopted in final form may differ in some material respects from those that were proposed. There is also a high likelihood that these rules will be challenged in court, which could further delay their implementation.

Share repurchase disclosure rule off the table

In December 2023, the U.S. Fifth Circuit Court of Appeals issued an order vacating the SEC's share repurchase disclosure rule, finding that the SEC had acted arbitrarily and capriciously in violation of the Administrative Procedure Act. Under the rule, SEC-registered corporate issuers would be required to file quarterly reports and related annual disclosures setting out more detailed disclosure of share repurchases, including the rationale for share repurchases.

Key takeaway – Registrants will not have to comply with the rule. The SEC has not indicated whether it will be re-proposing the rule, and no action regarding the rule is listed on the SEC's recently released regulatory agenda.

Cybersecurity in the headlines again

In October 2023, the SEC announced charges against software company SolarWinds Corporation and its chief information security officer for fraud and internal control failures relating to allegedly known cybersecurity risks and vulnerabilities. The complaint is the first time that the SEC has charged a company with scienter-based fraud in connection with alleged cybersecurity disclosure deficiencies. By contrast, three prior cybersecurity-related enforcement actions dating back to 2018 involved misstatements or omissions absent accusations of intent or recklessness. The SolarWinds action is also the SEC's first against an individual for scienter-based fraud relating to cybersecurity disclosures and its first litigated cybersecurity enforcement action. Please see our client briefing for further details.

Key takeaway – This is a significant step up in SEC enforcement action in the cybersecurity space. It highlights the importance of a robust cybersecurity and cyber resilience program that is incorporated throughout your organization, including your culture. It is also a reminder to review your disclosure controls and procedures to ensure that you appropriately detect and escalate cybersecurity risks and deficiencies to senior management, including the disclosure committee.

13D and 13G deadlines shortened

In October 2023, the SEC adopted amendments to Regulation 13D-G that shorten filing deadlines for the disclosure of beneficial ownership of publicly traded equity securities. The SEC also issued guidance regarding cash-settled derivative securities and the circumstances under which a group is formed under the regulation. The amendments follow a recent SEC enforcement sweep resulting from its review of beneficial ownership filing delinquencies.

Key takeaway – Beginning February 5, 2024, the initial Schedule 13D filing deadline will be five business days rather than 10 calendar days after the acquisition of more than 5% of covered securities, and amendments to Schedule 13D must be filed within two business days of the reportable event.

How do you report your cash flows?

In December 2023, SEC Chief Accountant Paul Munter issued a statement urging companies to consider reporting operating cash flows under the direct method, rather than the more common indirect method. Munter noted that the statement of cash flows is consistently a leading area of restatements. He encouraged issuers to carefully consider how to best present cash and noncash information, and whether additional information should be disclosed to facilitate an investor's understanding of the statement of cash flows and the financial statements as a whole.

Key takeaway – If you use the indirect method of reporting your statement of cash flows, the Chief Accountant's statement raises the prospect that you may see some SEC staff comment on your cash flow reporting method. The staff may ask you to further disaggregate amounts reported in the statement of cash flows (e.g., disclosing specific major classes of gross cash receipts and payments, such as cash collected from customers, cash paid to employees, and cash paid to suppliers) and/or to disclose additional information to better enable investors to understand the relationships between amounts reported in the statement of cash flows and those in the statement of financial position.

Nasdaq board diversity rule survives, for now

In October 2023, the Fifth Circuit Court of Appeals rejected a petition by conservative groups to review the SEC's approval of the Nasdaq rule requiring Nasdaq listed companies to disclose board of directors diversity information. Among other things, the court held that Nasdaq is not a "state actor" subject to constitutional scrutiny and that the rule could not be attributed to the SEC as a government actor. The groups also challenged the SEC's statutory authority on several bases, including a "major questions" argument relying on the Supreme Court's decision in *EPA v. West Virginia* to the effect that Congress did not explicitly authorize the SEC to approve a rule that concerns "major policy questions of vast economic and political significance." The court rejected the challenges, concluding that the SEC acted within its statutory authority in approving Nasdaq's rules.

Key takeaway – The decision was a rare victory for the SEC in the conservative Fifth Circuit, but it is not the end of the matter. The petitioners have filed for an *en banc* rehearing of the decision and have indicated that they intend to appeal the ruling to the Supreme Court if necessary.

Supreme Court could expand scope of Rule 10b-5 claims

In September 2023, the Supreme Court granted certiorari to address a circuit court split over whether private investors can bring Exchange Act Section 10(b)/Rule 10b-5 claims based on a company's alleged failure to make a disclosure required under Item 303 of Regulation S-K. Item 303 requires a company to disclose "known trends or uncertainties" that are likely to have a material impact on its financial position.

Key takeaway – The decision, expected next year, will be closely watched, as allowing private investors to bring Rule 10b-5 claims based on Item 303 violations will significantly expand the scope of Rule 10b-5.

The SEC's "Swiss Army statute"

It may be time to take another look at your internal processes, beyond your normal accounting controls, in light of recent enforcement actions indicating the SEC's broadening of the application of Securities Exchange Act Section 13(b)(2)(B).

Under Section 13(b)(2)(B), registrants must devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that, among other things, transactions are executed and access to assets is permitted only in accordance with management's general or specific authorization.

In recent years, the SEC has been using 13(b)(2)(B), in the words of SEC Commissioners Hester Peirce and Mark Uyeda, as "its own Swiss Army statute – a multi-use tool handy for compelling companies to adopt and adhere to policies and procedures that the Commission deems good corporate practice."

Commissioners Peirce and Uyeda made this statement in dissenting to the SEC's settled charges against Charter Communications Inc. for violating internal accounting controls requirements relating to its stock buybacks. Although the SEC did not charge the company with insider trading, it alleged that Charter's failure to conduct its buybacks in accordance with its Rule 10b5-1 plans was the result of a lack of internal accounting controls in violation of Section 13(b)(2)(B). The SEC's order concluded that Charter's repeated use of trading plans that did not conform to Rule 10b5-1 was the result of the company's insufficient internal accounting controls, and in particular, the absence of reasonably designed controls to analyze whether the discretion given to executives to alter the company's trading was consistent with the board's authorizations.

Commissioners Peirce and Uyeda argued, however, that the fundamental flaw in the SEC's order is its failure to distinguish between internal accounting controls and other types of internal controls. The order, they said, recites no facts suggesting that Charter's management used more funds than the board authorized for share buybacks, that management purchased shares at a quantity or time inconsistent with the board's authorization, or that management failed to properly record the expenditure of corporate funds and consequent purchase of shares on Charter's books. Instead, the order faults Charter because it lacked "reasonably designed controls to analyze" its trading plans for compliance with Rule 10b5-1. The Commissioners argued that "[c]ontrols designed to answer a legal question – compliance with the regulatory conditions necessary to qualify for an affirmative defense – are simply not internal accounting controls within Section 13(b)(2)(B)'s scope."

In 2020, the SEC brought similar charges against Andeavor, LLC, after finding that the company used an abbreviated and informal process to evaluate whether the requirements for share buybacks were satisfied.

And the SEC's action against SolarWinds, discussed earlier, also included a Section 13(b)(2)(B) charge, alleging that the company failed to devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that SolarWinds' access to assets was permitted only in accordance with management's general or specific authorization. In SolarWinds, the SEC contends that SolarWinds' critical assets included its IT network environment, source code and products. This differs from the traditional understanding that "assets" as defined in Section 13(b)(2)(B) refers to monetary assets.

Together, these enforcement actions highlight the SEC's willingness to use Section 13(b)(2)(B) beyond what may be understood to be internal "accounting" controls, even in the absence of allegations of improper trading or financial reporting disclosures. It may be time for a fresh review of your internal controls, particularly focusing on whether transactions are executed and access to assets is permitted in accordance with management's general or specific authorization.

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