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Quarterly Survey of SEC Rulemaking and Major Court Decisions (April 1, 2023 – June 30, 2023)

By Kenneth M. Silverman and Brian Katz[*]

This issue's Survey focuses on the U.S. Securities and Exchange Commission's ("SEC") rulemaking activities and other decisions relating to the Securities Act of 1933, as amended (the "1933 Act"), the Securities Exchange Act of 1934, as amended (the "1934 Act"), and other federal securities laws from April 1, 2023 through June 30, 2023.

This quarter, the SEC proposed four new rules and approved seven final rules. In pertinent part, the final and proposed rules continue the ongoing trend in recent years to modernize current regulatory frameworks in a manner that facilitates increased transparency and investor protection.

Final Rules

SEC Implements Amendments to Modernize Share Repurchase Disclosures

On May 3, 2023, the SEC adopted a final rule to modernize the disclosure requirements of issuers repurchasing registered equity securities. The new rules will apply to all issuers, including smaller reporting companies and foreign issuers, regardless of an issuer's filing status.

The final amendments will require companies to (i) disclose daily repurchase data in a new table filed as an exhibit to Forms 10-Q and 10-K, (ii) indicate whether any executives or directors traded in the issuer's equity securities within four business days before or after the public announcement of a repurchase plan, (iii) provide narrative disclosure about the repurchase program, including, among other things, objectives for the program, criteria used to determine amount of repurchased shares and rationale, and (iv) on a quarterly basis, provide disclosure of the issuer's adoption or termination of any trading arrangements pursuant to Rule 10b5-1 promulgated under the 1934 Act.

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New Exhibit

The final rules add new Item 408(d) of Regulation S-K to require that issuers provide a tabular disclosure of daily repurchase data in both quarterly and annual reports on Form 10-Q and Form 10-K, respectively, as a new Exhibit 26. Foreign private issuers will be required to report this same information quarterly on a new Form F-SR, and listed closed-end funds will need to report the information on semi-annual and annual reports on Form N-CSR. No exceptions to these reporting requirements exist, but the final rule is less onerous that the proposed rule's requirement of daily disclosure of daily repurchase data, rather than the consolidated reporting necessitated by the final rule. Exhibit 26 must provide the (i) class of shares purchased, (ii) the average price paid for share, (iii) the total number of shares purchased on a particular day, including the total number of shares purchased as part of a publicly announced repurchase plan, (iv) the aggregate maximum number of shares (or approximate dollar value) that is expected to be purchased under the publicly announced repurchase plan, (v) a breakout of shares purchased on the open market on a particular day, and (vi) the total number of shares purchased under the terms of a Rule 10b5-1 plan or in reliance of the non-exclusive safe harbor under Rule 10b-18 promulgated under the 1934 Act. The mandatory reporting includes share repurchases that are made pursuant to an increase in an already-existing repurchase plan, which further necessitates the ticking of a checkbox to precede the tabular disclose to indicate whether a Section 16 officer or director engaged in such repurchasing. Exhibit 26 must be provided in XBRL-tagged format.

Directors and Officers

Issuers will be required to indicate under the new disclosure requirements whether any directors and Section 16 officers or, for foreign private issuers, directors or senior management identified pursuant to Item 1 of Form 20-F, purchased or sold shares within four business days before or after public announcements about a share repurchase plan.

Narrative

The final rule expands the disclosure requirements set forth under Item 703 of Regulation-S-K, Form 20-F, and Form N-CSR beyond a tabular breakout of shares repurchased. Issuers must further provide enhanced narrative disclosure regarding the objective or rationale behind each repurchase plan or program and the process or criteria used to determine the amount of repurchases, including any policies and procedures relating to

purchases and sales of its securities by its officers and directors during a repurchase program and any restriction on such transactions. The narrative must describe any shares that were purchased by the issuer outside of a publicly announced plan or program and whether any share repurchase was made pursuant to circumstances such as a tender offer or employee compensation arrangement.

Disclosure Requirements for 10b5-1 Plans

Similar to the amendments to Rule 10b5-1 announced by the SEC on December 14, 2022 requiring quarterly disclosure of any director or officer adopting or terminating a Rule 10b5-1 trading arrangement, the SEC is requiring substantially similar disclosures regarding the adoption or termination of any such arrangements by an issuer. Companies will now be required to disclose the date on which it adopts or terminates a Rule 10b5-1 trading arrangement, including the duration of such arrangement and the aggregate number of shares to be purchased or sold thereunder.

Evaluation

Share buybacks have gained prominence in recent years as a means for companies to return capital to shareholders and manage their capital structures. These transactions have generated substantial debate and scrutiny, chief among them being concerns around the lack of transparency and accountability in the disclosure of share buyback activities. In recognition of these concerns, the SEC commenced rulemaking efforts to enhance transparency and provide investors with greater insight into the share repurchase activities of issues.

This rulemaking may require issuers to reevaluate, or at least reframe, its share buyback strategies as they consider how to craft the phasing of the "objectives and rationales" required to be disclosed pursuant to the final rule. The SEC has noted that such disclosures cannot be boilerplate, so tailoring disclosures for each repurchase instance will likely be necessary.

The final rules will become effective on July 31, 2023. Domestic issuers will required to comply with these new rules in their first Form 10-K or Form10-Q filed for the first full fiscal quarter beginning on or after October 1, 2023. Foreign private issuers must make their first disclosures using the new Form F-SR beginning with the first form that covers the first full fiscal quarter beginning on or after April 1, 2024. Registered closed-end investment companies subject to reporting on Form N-CSR are subject to the new disclosure requirements beginning with the first filing that covers the sixth-month period beginning on or after January 1, 2024.

SEC Adopts Final Rules to Prevent Fraud in Security-Based Swaps

On June 7, 2023, the SEC adopted final rules to enhance the regulatory framework around security-based swaps to combat fraud and market manipulation. The final rules provide specific prohibitions against attempting to manipulate the prices or valuations of security-based swaps, including related payments and deliveries, as well as protections for the compliance functions of security-based swap dealers and participants ("SBS Entities").

New Rule 9j-1(a) promulgated under the 1934 Act provides for certain explicit prohibitions on fraudulent or manipulative misconduct relating to security-based swap transactions. The new rule provides in part that it shall be unlawful for any person to effect, or attempt to effect, any transaction in a security-based swap in a manner that may (i) defraud or manipulate, (ii) involve untrue or misleading statements of a material fact, or the omission thereof, (iii) obtain money or property by means of any untrue statement of a material fact, (iv) engage in any act that may operate as fraud or deceit, (v) attempt to obtain money or property by means of any untrue statement of a material fact or omission of a material fact in such a manner that without its inclusion the statement would be misleading or which would operate in the course of business as fraud or deceit, or (vi) manipulate or attempt to manipulate the price or valuation of any security-based swap or any payment or delivery related thereto.

While the majority of findings of misconduct under Rule 9j-1(a) of the 1934 Act require scienter, the final rule notably establishes a broader prohibition on simply negligent conduct under Rule 9j-1(a)(4) of the 1934 Act, where a violation may be found when a person undertakes a particular act, practice, or course of dealing that, in practice, operates as fraud or deceit. The rulemaking further includes attempts to effectuate any transaction in prohibited manner as outlined above.

Rule 9j-1 includes two affirmative defenses from liability under the aforementioned prohibitions (i) through (v). First, where an action otherwise prohibited under the rule was taken in good faith pursuant to binding rights and obligations in a written security-based swap document, and so long as the security-based swap was entered into or the amendment was made before the person became aware of the material nonpublic information, such action shall not be unlawful. Second, with respect to entities, if the entity demonstrates that the individual at the entity making the investment decision was not aware of the material nonpublic information and the entity has implemented reasonable policies and procedures to prevent violations of the rule, no violation shall be found.

In addition, the final rule adopted Rule 15fh-4(c) promulgated under the 1934 Act, which seeks to prevent undue influence over the compliance functions of security-based swap participants. Rule 15fh-4(c) makes it unlawful for any officer, director, supervised person or employee of a SBS Entity to manipulate, mislead, or fraudulently influence such entity's chief compliance officer in the performance of their duties under federal securities laws or the rules and regulations thereunder. Activities that may run afoul of this rule include submission of false valuations or attempting to hinder or manipulate a chief compliance officer ("CCO") in the performance of their duties. The final rule seeks to protect the independence and objectivity of an SBS Entity's CCO, and, in consideration of the fact that there have been no public enforcement actions in this space to date, provide further push for SBS Entities to bolster the independence of their compliance functions.

The final rules will be effective 60 days after publication in the Federal Register.

SEC Implements Amendments to Remove References to Credit Ratings from Regulation M

On June 7, 2023, the SEC adopted final rules to remove and replace references to credit ratings from existing exceptions provided in Rule 101 and Rule 102 of Regulation M for investment grade securities with alternative measures of creditworthiness. Pursuant to Section 939A of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Dodd-Frank Act"), these final rules complete the SEC's mandate to remove reliance on, and references to, credit ratings from its rules and forms that has been attempted to be completed multiple times over the last 15 years. Additionally, the final rules include new recordkeeping requirements applicable to broker-dealers in connection with their reliance on the new exceptions for certain nonconvertible securities. Prior to adoption of the final rules, Rule 101(c) and Rule 102(d) of Regulation M (together, the "Investment Grade Exceptions") set forth exceptions to the prohibition of certain activities in connection with the distribution of covered securities, such as restricting distribution participants, issuers, selling security holders, and their affiliated purchasers, from engaging in bidding or purchasing covered securities during an applicable "restricted period." The final rule amends Rule 101(c)(2) and Rule 102(d)(2) of Regulation M by removing references to credit ratings from these regulations and substituting, in their place, new exceptions that are based on alternative measures of creditworthiness.

The final rule removes the requirement that nonconvertible

debt securities, nonconvertible preferred securities, and asset-backed securities be rated investment grade by at least one nationally recognized statistical rating organization ("NRSRO"). This credit rating requirement will be replaced by a determination by the distribution participant acting as the lead manager, such as a lead underwriter, of an issuer's probability of default derived from a "structural credit risk model," as newly defined in Rule 100 of Regulation M. The Investment Grade Exceptions are being replaced with a probability of default criterion, based on a structural credit risk model, requiring the issuer's probability of default to be 0.055% or less, estimated as of the sixth business day immediately preceding the determination of the offering price and over 12 full calendar months from that day. The probability of default determination must be documented in writing by the distribution participant acting as the lead manager.

In connection with distributions of asset-backed securities offered pursuant to an effective shelf registration statement on Form SF-3, the final rule provides for identical exceptions for distribution participants and their affiliate purchasers, as well as issuers, selling security holders, and their affiliate purchasers.

Finally, broker-dealers who rely on the new exception in Rule 101 or Rule 102 for certain nonconvertible debt securities and nonconvertible preferred securities must now preserve the written probability of default determination that supports their reliance on the exceptions for a period of at least three years.

The final rule will become effective August 21, 2023.

Proposed Rules

SEC Reopens Comment Period for Proposal to Modernize Beneficial Ownership Reporting

On April 28, 2023, the SEC reopened the comment period for amendments to Schedule 13D and 13G relating to beneficial ownership reports. The amendments were first proposed by the SEC on February 10, 2022 and remained substantially unchanged from the proposal detailed by this Journal for the first quarter of 2022. The amendments seek to modernize the disclosure required by investors who beneficially own more than five percent of a covered class of securities to, among other things, accelerate the deadline to file Schedules 13D and 13G, deeming holders of certain cash-settled derivative securities beneficial owners of the referenced covered class and clarifying the disclosure requirements in respect of derivative securities. The reopened comment period closed on June 27, 2023.

On the Horizon

SEC to Weigh New Artificial Intelligence Rules for Brokerages

Recognizing the increased use of artificial intelligence ("AI") in the financial industry, the SEC has continuously noted its intent to adapt the current regulatory regime to capture the increasingly critical role such technological tools play in our financial systems. Building off work the SEC began in 2021, on June 13, 2023, the SEC announced its plan to introduce regulations and rules regarding conflicts of interest that may arise with the proliferation of the use of technology, such as AI. Specifically, the SEC is considering recommending proposed rules related to broker-dealer conflicts in the use of predictive date analytics, AI, machine learning, and similar technologies in connection with certain investor interactions.

SEC Chair Gary Gensler has expressed concerns over whether brokers and financial advisors make recommendations that are in their client's best interests and that the use of new technologies by such financial professionals could present "inherent" conflicts of interest. Chair Gensler has noted that "technology, markets, and business models constantly change. Thus, the nature of the SEC's work must evolve as the markets we oversee evolve."

Michael Hsu, who leads the Office of the Comptroller of the Currency, illustrated the potential perils of utilizing AI within the financial system by explaining that while it has notable uses and efficiencies, "AI also presents significant challenges." Significant risks include the unpredictability of the technology, the capacity to spread discriminatory practices if AI systems are trained with biased data, and the threat of spreading fraud and misinformation. Bloomberg News has also reported that Wall Street banks are using and testing AI in their businesses and racing to hire more people in this specific area of expertise. Hsu warns that "While banks need to be adaptive and dynamic to thrive, they also need to safeguard trust by approaching innovation responsibly and purposefully."

The strong interest in implementing regulations on AI use by brokerages was introduced in the SEC's semiannual rule-writing agenda. Chair Gensler, in his statement regarding the agenda, claimed that "the items on the agenda would advance our three-part mission: to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation."

In connection with the potential conflicts of interest regulations, the SEC said it planned to propose requiring more robo-advisors or internet advisers to register as money managers with

the SEC, which carries additional requirements, as well as potentially requiring large brokers to calculate their customer reserve deposit requirements on a daily, rather than a weekly, basis.

There has been no formal proposed rule released by the SEC at this time. However, as disclosed by the SEC, we expect proposed rules to be issued during the fourth quarter of this year.

Recent Federal Legislation

M&A Broker Registration Exemption

Effective March 29, 2023, the U.S. Congress created a new statutory exemption from registration as a broker-dealer under the 1934 Act for M&A brokers. The exemption is largely based on a 2014 no-action letter issued by the SEC staff, which indicated that the SEC staff would not seek to require the registration of M&A brokers who limit their business to facilitating mergers and acquisitions involving privately held companies, provided certain conditions outlined in the 2014 no-action letter were satisfied. The new statutory exemption that went into effect on March 29, 2023 largely follows the 2014 no-action letter; however, the new statutory exemption includes certain new limitations regarding the size of the privately held company described in greater detail below.

An M&A broker for purposes of this new statutory exemption is a broker, and any person associated with a broker, engaged in the business of effecting securities transactions solely in connection with the transfer of ownership of an "eligible privately held company," regardless of whether the broker acts on behalf of a seller or buyer, through the purchase, sale, exchange, issuance, repurchase, or redemption of, or a business combination involving, securities or assets of the "eligible privately held company."

The new statutory exemption is only available for transactions involving an "eligible privately held company." An "eligible privately held company" is a privately held company that (i) does not have any class of securities registered, or required to be registered, with the SEC under Section 12 of the 1934 Act, and is not subject to SEC reporting requirements and (ii) in the fiscal year immediately before the fiscal year in which the services of the M&A broker are initially engaged with respect to the securities transaction, the company either had EBITDA of less than $25 million or the company's gross revenue was less than $250 million.

The new statutory exemption requires that M&A brokers must refrain from:

- Having custody of the buyer's or seller's funds or securities;
- Engaging in any public offering of securities as part of the transaction;
- Providing financing for the transaction;
- Assisting in obtaining financing from an unaffiliated third party unless any compensation for such arrangement is fully disclosed to the parties and the financing arrangement otherwise complies with applicable laws;
- Facilitating a transaction involving a shell company (other than a shell company formed solely to effect a business combination or reincorporation);
- Representing both the buyer and the seller unless they have provided written consent after receiving appropriate disclosures;
- Forming a consortium of buyers;
- Facilitating a sale to a passive buyer or group of buyers; and
- Acquiring authority to bind either the seller or the buyer.

An M&A broker that relies on the new statutory exemption must reasonably believe that, upon consummation of the transaction, any person acquiring securities or assets of the "eligible privately held company," acting alone or in concert will (i) control the "eligible privately held company" or the business conducted with the assets of the "eligible privately held company" and (ii) directly or indirectly, be active in the management of the "eligible privately held company" or the business conducted with the assets of the "eligible privately held company," such as electing officers, approving annual budgets or serving as an officer or other manager. Control will be deemed to be satisfied if the buyer acquires at least 25% of the voting power of the target company, or, in the case of a partnership or limited liability company, has the right to receive upon dissolution, or has contributed, 25% or more of the capital.

Following effectiveness of the new statutory exemption on March 29, 2023, the SEC revoked its 2014 no-action letter. The 2014 no-action letter cannot be relied on for situations that do not fall under the new statutory M&A broker exemption. Also, M&A brokers should be aware that the new statutory exemption does not preempt state law, which can lead to potential conflicts on a state level.

United States Supreme Court Vacated and Remanded Ninth Circuit Class-Action Decision in *Pirani v. Slack* that Expanded Liability Under Section 11 of the Securities Act

On June 1, 2023, the United States Supreme Court considered

on writ of certiorari whether Section 11 of the 1933 Act requires public buyers to allege and prove that they purchased shares traceable to a misleading registration statement. Straying from years of federal appellate precedent across various jurisdictions, the United States Court of Appeals for the Ninth Circuit held that it does not, affirming the lower court's denial of a motion to dismiss. The Supreme Court unanimously vacated and remanded the decision, reinforcing the narrow interpretation of section 11 that requires ties to an allegedly misleading registration statement in order for a plaintiff to state a claim under the 1933 Act.

Plaintiff Fiyyaz Pirani purchased a total of 250,000 shares of Slack Technologies, LLC ("Slack"), a technology company that provides an instant messaging platform, via a direct listing after the company publicly offered its shares on the New York Stock Exchange. Mr. Pirani subsequently filed a class-action lawsuit against Slack in the United States District Court for the Northern District of California when its stock price dropped, alleging that Slack filed a materially misleading registration statement in violation of Section 11 of the 1933 Act. Slack filed a motion to dismiss, arguing that Mr. Pirani failed to state a claim because the complaint did not allege that the shares Mr. Pirani purchased originated from Slack's allegedly misleading registration statement. The district court denied the motion to dismiss, holding that plaintiffs who purchase stock through a direct listing need not trace their shares to a false or misleading registration statement. The Ninth Circuit affirmed. No previous federal appellate court decision had adopted such an expanded interpretation of liability under Section 11 of the 1933 Act.

Under Section 11(a) of the 1933 Act, if "any part of the registration statement" contains "an untrue statement of a material fact" or is "misleading," "any person acquiring such security" may sue certain individuals involved with the registration statement. The Supreme Court's analysis turned on the meaning of "such security" in the 1933 Act. Mr. Pirani argued for a broad interpretation of "such security" that would cover securities with a "minimal relationship to a defective registration statement." Slack argued, in contrast, that "such security" in the statute refers specifically to a "security issued pursuant to an allegedly misleading registration statement." The Court analyzed the statute's context to determine that the latter interpretation is correct, emphasizing that no court of appeals had previously taken Mr. Pirani's position on the issue until this very case. The Ninth Circuit's investor-friendly decision therefore created a circuit split and, if affirmed, would have paved the way for expanded liability under Section 11 of the 1933 Act. However, the Supreme Court preserved the statute's narrow interpretation by vacating the Ninth Circuit decision and remanding the case.

Slack Techs., LLC et al. v. Pirani, case no. 22-200, in the Supreme Court of the United States.

Ninth Circuit Reheard Federal Derivative Action En Banc to Determine if Delaware Forum Selection Clause was Enforceable

On June 1, 2023, after deciding to rehear a contentious class-action decision en banc, the United States Court of Appeals for the Ninth Circuit affirmed dismissal of a derivative shareholder lawsuit that was filed in the United States District Court for the Northern District of California on *forum non conveniens* grounds, holding that a Delaware forum selection clause was enforceable. Plaintiff Noelle Lee, a shareholder of Gap, Inc. ("Gap"), filed the class-action lawsuit against Gap and its directors in 2020, alleging violations of Section 14(a) of the 1934 Act and SEC Rule 14a-9. Gap moved to dismiss, arguing that the forum selection clause in its bylaws required the action to be brought in the Delaware Court of Chancery. Despite multiple concerns raised by the plaintiff about the implications of enforcing the state forum selection clause in a derivative action that could only be brought in federal court, the district court dismissed the case in 2022. The Ninth Circuit affirmed, but then granted a rehearing en banc due to the contested nature of its decision, which conflicted with a Seventh Circuit decision that found a similar clause unenforceable that same year.

The court considered several issues in its latest consideration of the case: "(1) whether Gap's forum-selection clause is void because it violates the Exchange Act's antiwaiver provision, § 29(a), 15 U.S.C.A. § 78cc(a); (2) whether the forum-selection clause is unenforceable under *M/S Bremen v. Zapata Off-Shore Co.*, 407 U.S. 1 (1972), because enforcement would violate a strong public policy of the federal forum; and (3) whether Gap's bylaw is invalid because it is contrary to Delaware law." The court answered each question presented in the negative. Emphasizing the strong presumption that forum selection clauses are enforceable, the Ninth Circuit's preference for enforcing forum selection clauses, and the intent of Congress, the court held in a split decision: "In short, the Exchange Act voids Gap's forum-selection bylaw, and it is rendered unenforceable by the strong public policy expressed by Congress in the Exchange Act's antiwaiver and exclusive-jurisdiction provisions."

The court's decision reinforced a split of authority between the Ninth Circuit and the Seventh Circuit. It is yet unclear how courts will rule on the issue with respect to other mutually agreed-upon fora, but the Ninth Circuit's decision here establishes that shareholders may not circumvent Delaware forum selection

clauses when bringing federal derivative claims under Section 14(a) of the 1934 Act.

Lee v. Fisher et al., case no. 21-15923, in the United States Court of Appeals for the Ninth Circuit.