# Securities Regulation Law Journal

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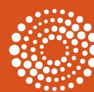

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# Quarterly Survey of SEC Rulemaking and Major Appellate Decisions (October 1, 2020—December 31, 2020)

*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 October 1, 2020 through December 31, 2020.*

The SEC finalized seventeen new rules for implementation, and proposed three new rules this quarter. After devoting substantial time and attention to addressing the challenges created by the COVID-19 pandemic during the first half of 2020, the SEC has been very active on the rulemaking front. Former Chair Jay Clayton announced a 32-item rulemaking agenda in October 2020 and made significant progress before leaving the SEC on December 23, 2020. Over Chair Clayton's nearly four-year term, the SEC adopted over 90 rules, "many in areas that had not been substantively addressed in decades."[1]

## *Final Rules*

### Fund of Fund Arrangements

On October 7, 2020, the SEC finalized new Rule 12d1-4 under the Investment Company Act of 1940 (the "Investment Company Act"). The SEC rescinded Rule 12d1-2 and the exemptive relief that permitted certain fund of funds arrangements. The SEC also amended Rule 12d1-1 under the Investment Company Act and made conforming changes to Form N-CEN. The new rule and amendments are intended to provide investors with the benefits of fund of funds arrangements, and will provide funds with investment flexibility to meet their investment objectives efficiently, in a manner consistent with the public interest and the protection of investors.

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Under Rule 12d1-4, a registered investment company or business development company ("BDC") (collectively, an "acquiring fund") may acquire the securities of any other registered investment company or BDC (collectively, an "acquired fund") in excess of the limits in section 12(d)(1), subject to the following conditions:

1. Rule 12d1-4 prohibits an acquiring fund and its advisory group from controlling an acquired fund, except in limited circumstances;
2. Rule 12d1-4 will require an acquiring fund and its advisory group to use mirror voting if it holds more than 25% of an acquired open-end fund or unit investment trust ("UIT") due to a decrease in the outstanding securities of the acquired fund and if it holds more than 10% of a closed-end fund, with the ability to use pass-through voting when acquiring funds are the only shareholders of an acquired fund;
3. Rule 12d1-4 will require investment advisers to acquiring and acquired funds that are management companies to make certain findings regarding the fund of funds arrangement, after considering specific factors. The final rule also will require certain findings with respect to UITs and separate accounts funding variable insurance contracts, taking into account the unique structural characteristics of such entities;
4. Rule 12d1-4 will require funds that do not have the same investment adviser to enter into an agreement prior to the purchase of acquired fund shares in excess of Investment Company Act section 12(d)(1)'s limits; and
5. Rule 12d1-4 will impose a general prohibition on three-tier investment structures with certain enumerated exceptions as a check on overly complex arrangements and excessive fees. However, in addition to these exceptions, the rule will allow an acquired fund to invest up to 10% of its total assets in other funds (including private funds), without regard to the purpose of the investment or types of underlying funds.

The SEC also amended Rule 12d1-1 to allow funds that rely on Investment Company Act section 12(d)(1)(G) to invest in money market funds that are not part of the same group of investment companies in reliance on that rule. With the rescission of Rule 12d1-2, a fund relying on Investment Company Act section 12(d)(1)(G) will no longer have flexibility to: (i) acquire the securities of other funds that are not part of the same group of investment companies; or (ii) invest directly in stocks, bonds, and other securities, except in compliance with Rule 12d1-4.

Rule 12d1-4 will become effective as of January 19, 2021, but, in order to facilitate a transition period, the compliance date for the amendments to Form N-CEN will become effective as of Janu-

ary 18, 2022. Further, the rescission of Rule 12d1-2 and the exemptive orders will become effective as of January 19, 2022.

## Qualifications of Accountants

On October 16, 2020, the SEC finalized multiple amendments to certain auditor independence requirements under Rule 2-01 of Regulation S-X for the purpose of modernizing the rules and to focus the analysis on relationships and services that are more likely to pose threats to an auditor's objectivity and impartiality. These amendments are intended to ease conflict of interest rules by giving auditors more discretion in assessing conflicts of interest with their clients and past lenders.

Prior to this amendment, audit firms were restricted from doing business with affiliates of an audit client in order to maintain their independence and assure public investors that their services were free of bias or conflict. The SEC recognized that this restriction was burdensome and hindered relationships between audit firms and their clients.

To address this concern, the SEC finalized amendments to Rule 2-01(f)(4). Under the amended rule, the definition of "affiliate of the audit client" now includes a dual materiality threshold where an entity that is under common control with the entity under audit (a "sister entity") will be considered an affiliate only if both the sister entity and the audit client are individually material to the controlling entity. For example, if Portfolio Company A is under common control with Portfolio Company B and engages Firm X for its audit, so long as Portfolio Company B is not material to the controlling entity, Portfolio Company B would likely be permitted to engage Firm X as its auditor absent some other relationship that would conflict with Rule 2-01(b). The SEC believes that where the entity under audit is not material to the controlling entity, an auditor's relationships with or services provided to sister entities would generally not threaten the auditor's objectivity and impartiality. In addition, the final rule includes changes to the definition of the investment company complex under Rule 2-01(f)(14) so that the dual materiality threshold described above will also apply to investment funds and in the investment advisory context.

The final rule also includes a reduction of the look-back period applicable to the independence of an auditor of a first-time SEC filer to one year for domestic filers. Prior to this final rule, domestic first-time filers were required to engage an auditor that was independent of them for all prior periods covered by the registration statement they file. This resulted in a look-back period of up to three years.

Lastly, the SEC introduced a transition framework to address

inadvertent independence violations where the independence violation arises as a result of a merger or acquisition, and the services or relationships that are the basis for the violation would not have violated the applicable independence standards prior to the merger or acquisition. Under amended Rule 2-01(e), auditors are required to:

1. Be in compliance with any independence standards that are applicable to the entities involved in the merger or acquisition transaction from the origination of the relationships or services in question and throughout the period in which the applicable independence standards apply;
2. Address any independence-impairing relationships or services before the effective date of the merger or acquisition, or, if impracticable to do so prior to such time, promptly after the effective date of such transaction. The SEC noted that they purposely did not explicitly state any time frame to promptly address these relationships or services, but expects that any necessary actions would be taken no later than six months after the effective date of the merger or acquisition; and
3. Have a quality control system in place, including procedures and controls that:
   a. Monitor the audit client's merger and acquisition activity to provide timely notice of a merger or acquisition; and
   b. Allow for prompt identification of potential violations after initial notification of a potential merger or acquisition that may trigger independence violations, but before the effective date of the merger or acquisition.

The final rule will become effective as of June 9, 2021.

## Private Offering Framework

On November 2, 2020, the SEC finalized amendments to the exempt offering framework. The current exempt offering framework is complex and made up of differing, exemption-specific requirements and conditions. The SEC believes that these amendments will facilitate capital formation and increase opportunities for investors by expanding access to capital for small and medium-sized businesses and entrepreneurs across the United States.

### Integration

New Rule 152(a) under the 1933 Act replaces the traditional five-factor integration test with the more recent approach to integration adopted with respect to Regulation A, Regulation

Crowdfunding and Rules 147 and 147A. New Rule 152(a) establishes a new integration framework that provides a general principle that considers the particular facts and circumstances of two or more offerings.

Under new Rule 152(a)(1), if an issuer is considering the application of the general principle to an exempt offering prohibiting general solicitation and one or more other offerings, then the issuer must have a reasonable belief, based on the facts and circumstances, with respect to each purchaser in the exempt offering prohibiting general solicitation, that the issuer either (i) did not solicit such purchaser through the use of general solicitation or (ii) established a substantive relationship with such purchaser prior to the commencement of the exempt offering prohibiting general solicitation. For example, issuers may conduct concurrent Rule 506(c) and Rule 506(b) offerings, or any other combination of concurrent offerings, involving an offering prohibiting general solicitation and another offering permitting general solicitation, without integration concerns, so long as the provisions of Rule 152(a)(1) and all other conditions of the applicable exemptions are satisfied.

However new Rule 152(a)(2) clarifies that, in addition to satisfying the requirements of the particular exemption relied on, general solicitation offering materials for one offering that include information about the material terms of a concurrent offering under another exemption may constitute an offer of the securities in such other offering.

In addition, the final rule provides four non-exclusive safe harbors from integration providing that:

1. Any offering made more than 30 calendar days before the commencement of any other offering, or more than 30 calendar days after the termination or completion of any other offering, will not be integrated with such offering, provided that, for an exempt offering for which general solicitation is not permitted that follows by 30 calendar days or more of an offering that allows general solicitation, then the provisions of new Rule 152(a)(1) applies;
2. Offers and sales made in compliance with Rule 701, pursuant to an employee benefit plan, or Regulation S will not be integrated with other offerings;
3. A registered offering will not be integrated if it is made subsequent to (a) a terminated or completed offering for which general solicitation is not permitted, (b) a terminated or completed offering for which general solicitation is permitted and made only to qualified institutional buyers and institutional accredited investors or (c) an offering for which general solicitation is permitted that terminated or com-

pleted more than 30 calendar days prior to the commencement of the registered offering; or

4. Offers and sales made in reliance on an exemption for which general solicitation is permitted will not be integrated if made subsequent to any terminated or completed offering.

## Rule 506(c) Verification Requirements

Rule 506(c) under the 1933 Act permits issuers to generally solicit and advertise an offering, provided that all purchasers in the offering are accredited investors, the issuer takes reasonable steps to verify that purchasers are accredited investors and certain other conditions in Regulation D are satisfied. Rule 506(c) provides a principles-based method for verification of accredited investor status as well as a non-exclusive list of verification methods. The final rule adds a new verification safe harbor to Rule 506(c). This new safe harbor permits an issuer to establish that an investor who the issuer previously took reasonable steps to verify as an accredited investor in accordance with Rule 506(c)(2)(ii) remains an accredited investor as of the time of a subsequent sale if the investor provides a written representation that the investor continues to qualify as an accredited investor and the issuer is not aware of information to the contrary. An issuer can rely on "bring down" written representations for a period of five years from the date the investor was previously verified as an accredited investor.

## "Test-the-Waters" and "Demo Day" Communications

The final rule amends the offering communications rules by adopting new Rule 241 under the 1933 Act, permitting an issuer to use generic solicitation of interest materials to "test-the-waters" for an exempt offer of securities prior to determining which exemption it will use for the sale of the securities. Issuers must include specific disclaimers in these materials in order to satisfy this new rule. An issuer, or any person authorized to act on behalf of an issuer, may communicate orally or in writing with potential investors to determine whether there is any interest in a contemplated offering of securities exempt from registration under the 1933 Act. New Rule 241 under the 1933 Act provides an exemption from registration only with respect to the generic solicitation of interest. The solicitation will be deemed to be an offer of a security for sale for purposes of the antifraud provisions of the Federal securities laws.

In addition, new Rule 206 under the Investment Advisers Act permits Regulation Crowdfunding issuers to "test-the-waters" prior to filing an offering document with the SEC in a manner similar to that permitted under Regulation A. Such issuers will

be permitted to "test-the-waters" with all potential investors. These issuers must include specific disclaimers in their "test-the-waters" materials in order to satisfy this new rule. These "testing-the-waters" materials will be considered offers that are subject to the antifraud provisions of the Federal securities laws. If an issuer engages in "testing-the-waters" under new Rule 206 under the Investment Advisers Act, such issuer will be required to include any solicitation materials with an offering document that is filed with the SEC.

Through new Rule 148 under the 1933 Act, the SEC also clarified that "demo day" communications will not be deemed to be general solicitation or general advertising if the communications are made in connection with a seminar or meeting sponsored by a college, university, a state or local government or instrumentality of a state or local government, a nonprofit organization or an angel investor group, incubator or accelerator ("Eligible Sponsors"). In order to comply with new Rule 148 under the 1933 Act, Eligible Sponsors are not permitted to:

1. Make investment recommendations or provide investment advice to attendees of the event;
2. Engage in any investment negotiations between the issuer and investors attending the event;
3. Charge attendees of the event any fees, other than reasonable administrative fees;
4. Receive any compensation for making introductions between event attendees and issuers, or for investment negotiations between the parties; or
5. Receive any compensation with respect to the event that would require an Eligible Sponsor to register as a broker or dealer under the 1934 Act, or as an investment adviser under the Investment Advisers Act of 1940, as amended (the "Investment Advisers Act").

Issuers will also have limitations on the information that they can convey at "demo day" events. The offering of securities by or on behalf of an issuer at a "demo day" event will be limited to the following:

1. Notification that the issuer is in the process of offering or planning to offer securities;
2. The type and amount of securities being offered;
3. The intended use of the proceeds of the offering; and
4. The unsubscribed amount in an offering.

## Offering and Investment Limits

The final rule also increases the offering size limitations and loosens investment limitations for Regulation A, Rule 504 of

Regulation D and Regulation Crowdfunding. Under Regulation A, the final rule increases the maximum offering amount under Tier 2 of Regulation A from $50 million to $75 million and increases the maximum offering amount for secondary sales under Tier 2 of Regulation A from $15 million to $22.5 million. Under Rule 504 of Regulation D, the final rule increases the maximum offering amount from $5 million to $10 million.

Under Regulation Crowdfunding, the final rule increases the offering limit from $1.07 million to $5 million. The final rule changes the investment limits for investors in Regulation Crowdfunding offerings by removing investment limits for accredited investors and now uses the greater of the investors' annual income or net worth when calculating the investment limits for non-accredited investors. Also, the final rule extends the existing temporary relief for 18 months, providing an exemption from certain Regulation Crowdfunding financial statement review requirements for issuers offering $250,000 or less of securities in reliance on the exemption within a 12-month period.

## Bad Actor Disqualifications

The final rule harmonizes the bad actor disqualification provisions of Regulation A, Regulation D and Regulation Crowdfunding by using the same disqualification lookback period. Prior to the final rule, the look back period for determining whether a covered person was disqualified differed between Regulation D and the other exemptions. For Regulation D, the lookback period was measured from the time of the sale of securities in the relevant offering, compared to Regulation A and Regulation Crowdfunding that measured the lookback period from the time the issuer filed an offering statement.

The final rule harmonizes the bad actor disqualification provisions by adjusting the lookback requirements in Regulation A and Regulation Crowdfunding to include the time of the sale in addition to the time of filing. The SEC believes that this revised lookback period will improve investor protections by further limiting the role of "bad actors" in exempt offerings and reducing the chance that investors may unknowingly participate in securities offerings involving offering participants who have engaged in fraudulent activities or violated securities or other laws or regulations. However, the final rule retains the current lookback period applicable to covered beneficial owners in Regulation A and Regulation Crowdfunding, rather than amending it to include the time of sale.

The final rule will become effective 60 days after publication in the Federal Register.

## Electronic Signatures

On November 17, 2020, the SEC finalized amendments to Rule 302(b) of Regulation S-T that will permit a signatory to an electronic filing to sign a signature page or other document (an "authentication document") with an electronic signature provided prescribed requirements are satisfied. This final rule will provide additional flexibility in complying with the authentication document requirement by providing signatories with the option of signing either manually or electronically in a manner consistent with the evidentiary purposes of the authentication document.

Prior to this final rule, each signatory to an electronic filing was required to sign an authentication document manually before or at the time of the electronic filing to authenticate, acknowledge or otherwise adopt the signature that appeared in typed form within the electronic filing. Under new Rule 302(b), a signatory has the option to use an electronic signature. This means that reporting companies will be able to file periodic and current reports and registration statements that have been signed electronically by appropriate parties, CEOs and CFOs will be able sign the certifications required to be filed with Forms 10-K and 10-Q electronically, and filers of Schedules 13D/G and Section 16 reports (Forms 3, 4 and 5) will be able to do so as well. The signing process for the electronic signature must:

1. Require the signatory to present a physical, logical or digital credential that authenticates the signatory's individual identity;
2. Reasonably provide for non-repudiation of the signature;
3. Provide that the signature be attached, affixed or otherwise logically associated with the signature page or document being signed; and
4. Include a timestamp to record the date and time of the signature.

The existing requirements under Rule 302(b) will be otherwise unchanged, including the requirements that an electronic filer retain the authentication document for a period of five years and furnish a copy of the authentication document upon request to the SEC.

In addition, under new Rule 302(b)(2), before a signatory initially uses an electronic signature to sign an authentication document, the signatory must manually sign a document attesting that the signatory agrees that the use of an electronic signature in any authentication document constitutes the legal equivalent of such individual's manual signature for purposes of authenticating the signature to any filing for which it is provided. SEC filers who have provided others with signature authority through powers of attorney may want to execute an addendum

granting such electronic signature authority, and reporting companies and others may want to revise their form power of attorney to include this attestation. An electronic filer must retain this manually signed document for as long as the signatory may use an electronic signature to sign an authentication document and for a minimum period of seven years after the date of the most recent electronically signed authentication document. Upon request, the electronic filer must furnish a copy of the manual signature to the SEC.

The SEC also amended the EDGAR Filing Manual and certain rules and forms under the 1933 Act, 1934 Act and Investment Company Act to permit the use of electronic signatures in authentication documents, rather than manual signatures. These amended rules and forms require filers to satisfy the same conditions listed above under Rule 302(b) for electronically signed authentication documents.

The final rule became effective as of December 4, 2020.

## Amendments to MD&A and Financial Disclosure Rules

On November 19, 2020, the SEC finalized a series of amendments to Regulation S-K under the 1933 Act that it believes will modernize, simplify and enhance certain financial disclosure requirements under Regulation S-K. The SEC's amendments focus on Items 301, 302 and 303, which prescribe certain reporting requirements for companies in their periodic reports on Forms 10-K and 10-Q, and in their registration statements.

The final rule eliminates Item 301 of Regulation S-K. Under Item 301, registrants were required to provide the last five years of selected financial data. The SEC believes that the elimination of Item 301 will modernize disclosure requirements in light of technological developments and to simplify disclosure requirements. The final rule also amends Item 302(a) of Regulation S-K. Under Item 302(a), registrants were required to provide two years of tabular selected quarterly financial data. This Item 302(a) will be replaced with a principles-based requirement for material retrospective changes. The SEC's purpose for amending this Item 302(a) is to reduce repetition and focus disclosure on material information.

In addition to eliminating Item 301 and amending Item 302(a), the SEC finalized amendments to Item 303 to encourage registrants to enhance the quality of their analysis in the MD&A section. The new rule lists principal objectives of MD&A in order to "emphasize a registrant's future prospects and highlight the importance of materiality and trend disclosures to a thoughtful MD&A."

The final rule amends Item 303(a)(3)(ii) (now adopted as Item 303(b)(2)(ii)) regarding known trends, uncertainties or events. Item 303(b)(2)(ii) requires registrants to disclose known trends, uncertainties or events that are "reasonably likely" to have a material impact on net sales, revenues or income or cause a material change in the relationship between costs and revenues, as opposed to requiring registrants to disclose such trends or events that "will" have a material impact or cause a material change.

Finally, the final rule amends Item 303(b) (now adopted as Item 303(c)) to provide flexibility by allowing companies to compare their most recently completed quarter to either the corresponding quarter of the prior year (as is currently required) or the immediately preceding quarter. Under this amendment, if in a subsequent Form 10-Q, a registrant changes the comparison from the comparison presented in the immediately prior Form 10-Q, the registrant is required to explain the reason for the change and present both comparisons in the filing where the change is announced. The SEC believes that the flexibility provided by this amendment will help registrants provide a more tailored and meaningful analysis that is relevant to their specific business cycles while also providing investors with material information to assess quarterly performance.

The final rule will become effective 30 days after publication in the Federal Register. Registrants are required to comply with the final rule beginning with the first fiscal year ending on or after the date that is 210 days after publication in the Federal Register.

## SEC Allows NYSE Companies to Sell Share in Direct Listings

On December 22, 2020, the SEC announced, after a formal review process of the initial approval on August 26, 2020, that companies listed on the New York Stock Exchange (the "NYSE") will be able to conduct an initial public offering as part of a direct listing without conducting a firm commitment underwritten offering. This will give companies another option to initially list their shares without going through the traditional IPO process.

Currently, the NYSE recognizes that companies that have not previously had their common equity securities registered under the 1934 Act, but that have sold common equity securities in a private placement, may wish to list their common equity securities on the NYSE at the time of effectiveness of a registration statement filed solely for the purpose of allowing existing shareholders to sell their shares. Under this new rule, a company that has not previously had its common equity securities registered under the 1934 Act would list its common equity securities on the NYSE at the time of effectiveness of a registration

statement pursuant to which the company itself would sell shares in the opening auction on the first day of trading on the NYSE in addition to, or instead of, facilitating sales by selling shareholders (defined as a "Primary Direct Floor Listing"). A company can engage in a Primary Direct Floor Listing if the following conditions are satisfied:

## Aggregate Market Value of Publicly Held Shares Requirement

With respect to the aggregate market value of publicly held shares requirement, a company will satisfy the requirements of a Primary Direct Floor Listing if the company will sell at least $100 million in market value of shares in the NYSE's opening auction on the first day of trading. Alternatively, if a company will sell shares in the opening auction with a market value of less than $100 million, the NYSE will deem the company to have met such requirement if the aggregate market value of the shares the company will sell in the opening auction on the first day of trading and the shares that are publicly held immediately prior to listing is at least $250 million. Market value will be calculated using a price per share equal to the lowest price of the price range multiplied by the number of shares being offered by the issuer.

## Opening Auction Process for Primary Direct Floor Listings

Under this new rule, a new order type can be used by the issuer in a Primary Direct Floor Listing. Specifically, the NYSE has introduced an Issuer Direct Offering Order (an "IDO Order"), which will be a Limit Order to sell that is to be traded only in a direct listing auction for a Primary Direct Floor Listing. The IDO Order has the following requirements:

1. Only one IDO Order may be entered on behalf of the issuer and only by one member organization;
2. The limit price of the IDO Order must be equal to the lowest price of the price range established by the issuer in its effective registration statement (defined as the "Primary Direct Floor Listing Auction Price Range");
3. The IDO Order must be for the quantity of shares offered by the issuer, as disclosed in the prospectus in the effective registration statement;
4. The IDO Order may not be canceled or modified; and
5. The IDO Order must be executed in full in the direct listing auction.

The SEC believes that it is appropriate for the IDO Order to

have priority over other sell orders at the same price if the auction price is at the limit price of the IDO Order because the auction will not occur at all unless the IDO Order is fully satisfied. This will allow for both the issuer's IDO Order and better-priced sell orders to be executed in the opening auction. The SEC believes that these requirements mitigate concerns about the price discovery process in the opening auction and provide reasonable assurance that the opening auction and subsequent trading promote fair and orderly markets that are designed to prevent manipulative acts and practices, and protect investors and the public interest.

### Lack of Traditional Underwriter Involvement in a Primary Direct Floor Listing

The SEC agrees with the NYSE's opinion that the 1933 Act does not require the involvement of an underwriter in registered offerings. The SEC also believes that these new rules are consistent with the protection of investors. This new rule requires all Primary Direct Floor Listings to be registered under the 1933 Act, and thus subject to the existing liability and disclosure framework under the 1933 Act for registered offerings. Among other disclosures, these registration statements will require bona fide price ranges and audited financial statements prepared in accordance with either U.S. GAAP or International Financial Reporting Standards as issued by the International Accounting Standards Board.

## SEC Overhauls Marketing Rules for Investment Advisers

On December 22, 2020, the SEC finalized amendments to modernize rules that govern investment adviser advertisements and compensation to solicitors under the Investment Advisers Act. The final rule creates a single rule (the "Marketing Rule") that draws from and replaces the current advertising and cash solicitation rules under Rules 206(4)-1 and 206(4)-3 under the Investment Advisers Act. The SEC also made related amendments to Form ADV and Rule 204-2 (also known as the "books and records rule").

The final rule includes an amendment to the definition of an "advertisement" under the Marketing Rule. The definition of an "advertisement" has two prongs, first, the definition includes any direct or indirect communication an investment adviser makes that: (i) offers the investment adviser's investment advisory services with regard to securities to prospective clients or investors in a private fund advised by the investment adviser ("private fund investors") or (ii) offers new investment advisory services

with regard to securities to current clients or private fund investors. This first prong of the definition excludes most one-on-one communications and contains certain other exclusions. The second prong of the definition includes any endorsement or testimonial for which an adviser provides cash and non-cash compensation directly or indirectly.

The Marketing Rule will prohibit certain advertising practices in order to prevent fraudulent, deceptive or manipulative acts. These prohibited advertising practices include prohibitions on untrue statements or omissions of a material fact, unsubstantiated statements of material fact, untrue or misleading implications or inferences of material fact, failure to provide fair and balanced treatment of material risks, and any other information that otherwise is materially misleading.

In addition, the Marketing Rule prohibits the use of testimonials and endorsements in an advertisement, unless the adviser satisfies certain disclosure, oversight and disqualification requirements. In order to comply with the disclosure requirements, advertisements must clearly and prominently disclose whether the person giving the testimonial or endorsement (a "promoter") is a client and whether the promoter is compensated. Additional disclosures are required regarding compensation and conflicts of interest.

The Marketing Rule eliminates the current rule's requirement that the adviser obtain from each investor acknowledgements of receipt of the disclosures. In order to comply with the oversight requirements mentioned above, an adviser that uses testimonials or endorsements in an advertisement must oversee compliance with the Marketing Rule. An adviser also must enter into a written agreement with promoters, except where the promoter is an affiliate of the adviser or the promoter receives de minimis compensation (i.e., $1,000 or less, or the equivalent value in non-cash compensation, during the preceding twelve months). In order to comply with the disqualification requirements, the Marketing Rule prohibits certain "bad actors" from acting as promoters.

The Marketing Rule also prohibits including in any advertisement gross performance, unless the advertisement also presents net performance, as well as prohibiting other performance results for specific time periods, prohibiting statements related to any calculation of performance results that the SEC has approved or reviewed and prohibiting the use of hypothetical performance unless specific conditions are satisfied.

Finally, the final rule amends Form ADV and the books and records rule, merging the adopted amendments to the Marketing Rule into Form ADV and the books and records rule. In addition, the final rule amends Form ADV to require advisers to provide

additional information regarding their marketing practices to help facilitate the SEC's inspection and enforcement capabilities.

The final rule will become effective 60 days after publication in the Federal Register.

## *Proposed Rules*

### Proposed Amendments to Rule 701 and Form S-8

On November 24, 2020, the SEC proposed amendments to Rule 701, which provides an exemption from registration for securities issued by non-reporting issuers pursuant to compensatory arrangements, and Form S-8, the registration statement for compensatory offerings by reporting issuers. The proposed amendments to Rule 701 and Form S-8 are designed to modernize the framework for compensatory securities offerings in light of the evolution in compensatory offerings and composition of the workforce.

In July 2018, the SEC issued a Concept Release that solicited public comment on ways to modernize Rule 701 and Form S-8. Informed by commenters to the Concept Release, the SEC proposed these amendments to modernize the framework for compensatory securities offerings, consistent with investor protection.

#### Disclosures Under Rule 701

Under current Rule 701(e), if sales by an issuer will exceed $10 million in any consecutive 12-month period, the issuer is required to provide additional disclosures under Rule 701(e) to all investors prior to the sale, even if the sale is made before the threshold is exceeded. The SEC has proposed revisions to Rule 701(e) to provide that, if the aggregate sales price or amount of securities sold during any consecutive 12-month period exceeds $10 million, the issuer must deliver to investors the additional disclosure required by the rule only with respect to those sales after the $10 million threshold is exceeded.

Once the $10 million threshold is exceeded, issuers are required to prepare certain financial statements. However, the proposed amendments to Rule 701(e) change the current financial statement requirements. Currently, issuers who exceed the $10 million threshold must prepare financial statements on a quarterly basis. Under the proposed rule, financial statements will only be required on a semi-annual basis and be completed within three months after the end of the issuer's second and fourth quarters.

Currently, all foreign private issuers relying on the Rule 701 exemption must provide a reconciliation to U.S. GAAP if the

foreign private issuer's financial statements are not prepared in accordance with U.S. GAAP or International Financial Reporting Standards to satisfy the disclosure requirements under Rule 701(e). For purposes of Rule 701(e), the proposed rule would allow foreign private issuers that are eligible for the exemption from registration under Rule 12g3-2(b) of the 1934 Act to provide financial statements prepared in accordance with the foreign private issuers' home country accounting standards without reconciliation to U.S. GAAP.

Under current Rule 701(e)(6), if a sale involves a stock option or another derivative security, such as a restricted stock unit ("RSU") or performance stock unit ("PSU"), the issuer must deliver disclosure in a reasonable period of time before the date of exercise or conversion. The proposed amendments attempt to clarify the distinction between derivative securities that involve a decision to exercise or convert, and those that do not. If the sale involves a stock option or other derivative security that involves a decision to exercise or convert, the issuer would continue to be required to deliver disclosure in a reasonable period of time before the date of exercise or conversion. If the sale involves an RSU or other derivative security that does not involve a decision to exercise or convert, the issuer generally would continue to be required to deliver disclosure in a reasonable period of time before the date the RSU or similar derivative security is granted. In addition, for the grant of an RSU or similar derivative security made in connection with the hire of new employees, the disclosure would be considered delivered in a reasonable period of time before the date of sale if it is provided no later than 14 calendar days after the date the person begins employment.

The SEC also proposed amendments under Rule 701(e) to clarify that after the completion of a business combination transaction, as long as the acquired entity complied with Rule 701 at the time it originally granted the derivative securities, the exercise or conversion of those derivative securities that are assumed by the acquiring issuer would be exempt from registration, subject to the acquiring issuer's compliance with Rule 701(e).

## Registration Amendments to Form S-8

The proposed rule would clarify that issuers may add additional plans to an existing Form S-8. Specifically, issuers may file an automatically effective post-effective amendment to a previously filed Form S-8 to add employee benefit plans where the new plan does not require the authorization and registration of additional securities for offer and sale. The proposed rule would also clarify that issuers are not required to allocate registered securities among incentive plans and may use a single Form S-8 for

multiple incentive plans. For issuers utilizing this flexibility, the initial registration statement would be required to list the types of securities covered by the registration statement and identify the plan or plans pursuant to which the issuer intended to issue securities as of that date. The SEC believes this will reduce administrative burdens for those issuers that believe they must use a separate Form S-8 for each plan. In addition, the proposed rule would amend Rule 413 under the 1933 Act to permit issuers to add securities to an existing Form S-8 by filing an automatically effective post-effective amendment.

### Calculating Fee Payment Amendments to Form S-8

The proposed rule would amend Rule 457 under the 1933 Act and Form S-8 to permit registration of an indeterminate number of securities to be sold under the issuer's defined contribution plans. Upon the yearly calculation and payment of the registration fee within 90 days of the issuer's fiscal year end, issuers that had registered an indeterminate number of securities on Form S-8 for defined contribution plan would need to calculate their registration fee by multiplying the aggregate offering price of securities sold during the fiscal year by the fee payment rate in effect on the date of the fee payment. The SEC believes that a fee calculation based on the aggregate offering amount of securities sold pursuant to defined contribution plans could simplify plan administration by eliminating the need to track offers and sales of individual shares of issuer stock within unitized plans.

Comments on the proposed rules should be received on or before February 9, 2021.

## Proposed Amendments to Rule 144 and Form 144

On December 22, 2020, the SEC proposed amendments to Rule 144 under the 1933 Act to revise the holding period for securities acquired upon the conversion or exchange of certain market-adjustable securities. The proposed rule would also modify the filing requirements for Form 144.

Section 5 of the 1933 Act requires registration of all offers and sales of securities in interstate commerce or by use of the United States mails, unless an exemption from the registration requirement is available. One of the conditions of Rule 144 for restricted securities is that a selling security holder must have held the securities for a specified period of time prior to resale. Currently, Rule 144 permits "tacking" of the holding period for convertible securities. Specifically, Rule 144(d)(3)(ii) allows securities acquired solely in exchange for other securities of the same issuer to be deemed to have been acquired at the same time as the securities surrendered for conversion or exchange.

The proposed rule would amend Rule 144(d)(3)(ii) to eliminate "tacking" for securities acquired upon the conversion or exchange of the market-adjustable securities of an issuer that does not have a class of securities listed, or approved to be listed, on a national securities exchange. The purpose of this proposed amendment is to avoid the potential, under the current safe harbor provided in Rule 144, for holders to acquire market-adjustable securities with a view to an unregistered distribution of the underlying securities acquired upon their conversion or exchange, resulting in significant resales of the underlying securities without investors having the benefit of registration.

The proposed rule would not affect the use of Rule 144 for most convertible or variable-rate securities transactions. The proposed rule would apply only to market-adjustable securities transactions where:

1. The newly acquired securities were acquired from an issuer that, at the time of the conversion or exchange, does not have a class of securities listed, or approved for listing, on a national securities exchange registered pursuant to Section 6 of the 1934 Act; and
2. The convertible or exchangeable security contains terms, such as conversion rate or price adjustments, that offset, in whole or in part, declines in the market value of the underlying securities occurring prior to conversion or exchange, other than terms that adjust for stock splits, dividends or other issuer-initiated changes in its capitalization.

The SEC believes that this proposed amendment would reduce the potential for unregistered distributions because after the conversion or exchange of the overlying convertible securities, the underlying securities would need to be held for the applicable holding period under Rule 144 before they would be eligible for resale under the Rule 144 safe harbor.

In addition, the proposed rule would amend Form 144. Form 144 is a notice form that must be filed with the SEC by an affiliate of an issuer who intends to resell restricted or control securities in reliance upon Rule 144. The proposed rule would amend Rules 101(a) and 101(b) of Regulation S-T to mandate the electronic filing of all Form 144 filings for the sale of securities of 1934 Act reporting companies, and eliminate the paper filing option. The proposed rule would also amend Rule 101(c)(6) of Regulation S-T to require affiliates relying on Rule 144 to file a notice of sale on Form 144 only when the issuer of the securities is subject to the reporting requirements of Section 13 or 15(d) of the 1934 Act. If the SEC adopts the proposed amendments to Form 144 mentioned above, the SEC intends to modify the filing deadline for Form 144 so that Form 144 may be filed concur-

rently with Form 4 by persons subject to both filing requirements. Finally, the proposed rule would amend Forms 4 and 5 to add an optional check box to indicate that a reported transaction was intended to satisfy Rule 10b5-1(c), which provides an affirmative defense for trading on the basis of material non-public information in insider trading cases.

Comments on the proposed rule should be received on or before 60 days after publication in the Federal Register.

## United States District Court for the Northern District of California Dismisses Shareholder Allegations that Twitter and its Executives Misled Investors

On December 10, 2020, the United States District Court for the Northern District of California dismissed a Consolidated Class Action Complaint brought by several investors (collectively, "Plaintiffs") against Twitter, Inc. ("Twitter") and members of its senior management (collectively, "Defendants"). Plaintiffs alleged that Defendants violated Section 10(b) of the Securities Exchange Act and Rule 10b-5 promulgated thereunder and violated Section 20(a) of the Securities Exchange Act by misleading investors through a series of statements released in Twitter SEC filings and omitted statements concerning problems with its targeted advertising feature and the effect of those issues on Twitter's revenue.

Plaintiffs commenced this action against Defendants on behalf of investors who purchased or otherwise acquired Twitter securities from July 26, 2019 through October 23, 2019. On October 24, 2019, Twitter's share price fell from $38.83 per share to $30.73, a drop of $8.10 per share. Plaintiffs alleged that Defendants failed to disclose that steps taken to fix issues with a bug in its targeted advertising system impacted advertising function and caused a decline in Twitter's advertising revenue. Plaintiffs alleged that Defendants should have disclosed the financial implications associated with fixing the bug.

The District Court a found that Plaintiffs failed to allege facts giving rise to a strong inference of scienter, as Defendants "vaguely optimistic statements" should have been understood by reasonable investors as puffery. The Court also deemed Defendants' statements to be forward-looking statements which were accompanied by meaningful cautionary language.

In re Twitter, Inc. Securities Litigation, Case No. 19-cv.07149-YGR (N.D. Cal. Dec. 10, 2020).

## United States District Court of New Jersey Dismisses Shareholder Allegations that Campbell Soup and its Senior Executives Misled Investors

On November 30, 2020, the United States District Court of New Jersey dismissed a Class Action Lawsuit brought by investors ("Plaintiffs") against Campbell Soup Co. ("Campbell") and certain of Campbell's senior executives (collectively, "Defendants"). Plaintiffs alleged that Defendants violated Section 10(b) of the Securities Exchange Act and Rule 10b-5 promulgated thereunder and Section 20(a) of the Securities Exchange Act by overstating Campbell's financial projections for its fresh foods division.

Plaintiffs alleged that Defendants intentionally misled investors through statements made in press releases, SEC filings, and investor conferences which contradicted the evidence of falling revenues for Campbell's new fresh foods division. Among other things, Plaintiffs referred to Defendants' statement that (i) Defendants expect to see top line growth in Campbell's new fresh foods division, (ii) Defendants expect the new fresh foods division to return to profitable growth, (iii) Defendants' statement that the new fresh foods division's turnaround was progressing, and (iv) Defendants' statement that they expected to see profitability quickly. Plaintiffs ultimately alleged that the statements made by Defendants were misleading regarding the success of the division and that the fresh foods division, which allegedly lost money, negatively affected Campbell's stock price.

The District Court found that Plaintiffs failed to allege facts giving rise to a strong inference of scienter, as Plaintiffs failed to plead enough allegations "that demonstrate the [D]efendants were aware of facts that were actually contrary to the individual [D]efendants' expectations of top line growth and profitability for 2018." The Court stated that evidence suggested that Defendants really believed that the sale of other Campbell products and various strategic endeavors would yield profit for Campbell. The Court held that the Plaintiffs needed to plead more facts demonstrating that Defendants were either aware of facts that were actually contrary to their statements.

In re Campbell Soup Company Securities Litigation, Civ. No. 18-14385 (NLH/JS) (D.N.J. Nov. 30, 2020).

**NOTES:**

[1] https://www.sec.gov/news/public-statement/clayton-2020-12-23.