PAUL HASTINGS

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Public Company Watch

Key Issues Impacting Public Companies

SEC Spotlight

SEC Staff Issues Statement Clarifying Disclosure Requirements for Cybersecurity Incidents in Form 8-K

On May 21, 2024, the Securities and Exchange Commission ("SEC") Director of Corporation Finance, Eric Gerding, issued a **statement** clarifying the requirements for the disclosure of cybersecurity incidents pursuant to Form 8-K. In the statement, Director Gerding reiterated that Item 1.05 was added to Form 8-K to require public companies to disclose *material* cybersecurity incidents, and while Item 1.05 does not prohibit the *voluntary* disclosure of an immaterial cybersecurity incident, or a cybersecurity incident for which materiality has not yet been determined, it is only triggered upon determination that the incident was actually material. As such, companies are encouraged to use Item 1.05 to disclose only *material* cybersecurity incidents and to make any voluntary cybersecurity disclosure under a different Form 8-K Item, such as Item 8.01.

Director Gerding remarked that this clarification is not meant to discourage the voluntary disclosure of immaterial cybersecurity events, or incidents for which a materiality determination is still being made, noting that such voluntary disclosures are valuable to companies and to investors. Rather, the clarification is intended to encourage companies to make any voluntary disclosures *outside* of Item 1.05 in order to avoid confusion and to make it easier for investors to distinguish between material and immaterial cybersecurity incidents.

In the statement, Director Gerding also addressed materiality determinations and impact assessments for cybersecurity events, noting that companies "should assess all relevant factors" when determining whether an incident is material and assessing its potential impacts.[1] Quoting the Adopting Release for the cybersecurity rules, Director Gerding reiterated that assessments "should not be limited to the impact on 'financial condition and results of operation,' and 'companies should consider qualitative factors alongside quantitative factors.'"[2] For example, companies should consider how an incident may affect its reputation or relationships with suppliers or customers, or whether there is a risk of regulatory investigations or litigation stemming from the incident.

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1 Statement by the Director of the Division of Corporation Finance, U.S. Securities and Exchange Commission, *Disclosure of Cybersecurity Incidents Determined To Be Material and Other Cybersecurity Incidents[*]*, **https://www.sec.gov/news/statement/gerding-cybersecurity-incidents-05212024#_ftn5** (hereinafter, "SEC Statement").

2 SEC Statement, quoting *Cybersecurity Risk Management, Strategy, Governance, and Incident Disclosure*, Release Nos. 33-11216; 51907 (July 26, 2023) [88 FR 51896 (Aug. 4, 2023)].

In instances where a company suffers a significant cybersecurity incident that the company knows is material but does not yet know the impact, the company should disclose the incident under Item 1.05 and note that it is still assessing the impacts. Once the impact has been assessed, the company should then amend its Form 8-K to include information on the impacts of the incident, as required by Item 1.05 of Form 8-K.

Reminder of Transition to T+1 Securities Settlement Cycle

On May 28, 2024, the shortened standard settlement period for most broker-dealer transactions from the current two business day settlement period (T+2) to one business day (T+1) went into effect. Under the T+1 settlement cycle, applicable securities transactions are required to settle within one business day of the transaction date, unless another settlement period is expressly agreed at the time of the transaction. The change was adopted by the SEC in February 2023 as part of the amendments to Exchange Act Rule 15c6-1(a).

T+1 settlement applies to most securities transactions with a transaction date on or after Tuesday, May 28, 2024, subject to certain limited exceptions, including transactions involving contracts to purchase unlisted limited partnership interests, security-based swaps and certain exempted securities (as determined by the SEC from time to time). In addition, firm commitment underwritten registered offerings of securities priced after 4:30 pm Eastern Time will continue to be settled on a T+2 settlement cycle, unless another settlement period is agreed upon by the parties at the time of the transaction.

End of Transition Period for Insider Trading Disclosure for March 31 Year-End Companies

In December 2022, the SEC adopted amendments that, among other things, require public companies to disclose information related to their insider trading policies and procedures and their equity compensation awards practices in relation to the release of material nonpublic information. The amendments provided a transition period for compliance with the new disclosure requirements and related XBRL tagging requirements in Exchange Act reports and proxy or information statements, with compliance required for the first filing that covers the full fiscal period beginning on or after April 1, 2023 (or October 1, 2023 for smaller reporting companies).

As a result, for companies with a fiscal year ending on or after March 31, 2024 (other than smaller reporting companies), the new insider trading related disclosure and tagging requirements are now in effect and will be required in upcoming annual reports and proxy or information statements. Smaller reporting companies must begin complying with the insider trading disclosure requirements in annual reports and proxy or information statements for fiscal years ending on or after September 30, 2024.

Reminder of Requirements for Domestic Companies

Regulation S-K Item 408: Item 408(a) requires companies to disclose any trading arrangements adopted or terminated by directors or officers during the last fiscal quarter. Item 408(b) requires companies to disclose whether they have adopted insider trading policies that are reasonably designed to promote compliance with insider trading laws, and to file such policies and procedures as an exhibit to their annual report. If insider trading policies and procedures have not been adopted, companies are required to explain why they have not been adopted. Disclosure under Item 408 must also be XBRL tagged. Item 408(c) provides a definition of non-Rule 10b5-1 trading arrangements and Item 408(d) has been reserved.

Regulation S-K Item 402(x): Item 402(x) requires companies to disclose their policies and practices regarding the timing of awards of options, stock appreciation rights, and similar option-like instruments, to named executive officers that occur close in time to the company's disclosure of material nonpublic information and include tabular disclosure of grants made close in time to the release of material nonpublic information. Disclosure under Item 402(x) must also be XBRL tagged.

Reminder of Requirements for Foreign Private Issuers

Form 20-F Item 16J: New Item 16J requires foreign private issuers to disclose the information required by Regulation S-K Item 408(b) and to file their insider trading policies and procedures as an exhibit to their Form 20-F. Disclosures under Item 16J must also be XBRL tagged.

For more details on the insider trading related disclosure requirements, see our **client alert** from December 2022 covering the final rules.

Activism Update

Defending Against Consent Solicitations and Special Meeting Demands

When a public company assesses its structural vulnerabilities to shareholder activism, one important component is whether the company provides shareholders with the ability to act outside of the annual meeting cycle through written consents or special meeting demands. If shareholders are not afforded such rights in a company's organizational documents, an activist is typically unable to effectuate changes to a company's Board composition outside of the annual meeting cycle. However, even if the organizational documents allow for consent solicitations and shareholder requested special meetings, there are still structural defenses available to a company to limit what an activist can achieve through a consent solicitation or special meeting demand.

Specifically, a company should review whether shareholders have the right to remove directors, the right to determine the size of the Board, and the right to fill Board vacancies. If shareholders do not have the power to (1) create vacancies by either removing directors or expanding the size of the Board and (2) fill those vacancies, then an activist's ability to effectuate a change in Board composition through a consent solicitation or through a special meeting will be significantly limited.

Creating Director Vacancies

In order to effect changes in Board composition at a special meeting or via written consent, shareholders must, as a threshold matter, have the power to create director vacancies. This can be accomplished in one of two ways:

- Removal of Director(s): Shareholders may create vacancies by removing incumbent directors at a special meeting or via written consent. For Delaware corporations with a classified Board, unless the certificate of incorporation provides otherwise, directors can only be removed for cause, which, absent extreme circumstances, effectively prevents activists from removing directors. For Delaware corporations with an annually elected Board, directors can be removed with or without cause.
- Expanding the Size of the Board: Shareholders can also create vacancies by expanding the size of the Board. The certificate of incorporation of many Delaware public companies vests the Board of Directors with the sole power to fix the size of the Board. Absent such provision in the charter, shareholders may be able to amend the company's bylaws to allow shareholders to change the size of the Board and thus create vacancies.

Filling Director Vacancies

However, even if shareholders can create director vacancies through director removals or by expanding the size of the Board, the activist would not get very far unless shareholders also have the right under the company's organizational documents to fill vacancies on the Board. The certificate of incorporation of most Delaware public companies vests the Board of Directors with the sole power to fill vacancies. Absent such charter provision, shareholders may be able to amend the bylaws to give shareholders the exclusive power to fill vacancies created by shareholder action.

A company with a charter that does not properly vest the Board of Directors with sole power to fix its size and fill vacancies is open to an activist threat to create and fill vacancies via a written consent or at a special meeting. Note that even if bylaw amendments are needed to effect such action, shareholders may be able to implement such bylaw changes at the same special meeting or written consent solicitation at which the actual vacancies are created and filled by pre-conditioning the effectiveness of the latter on approval of the requisite bylaw amendments.

An activist may try to get around a charter prohibition on shareholders filling vacancies by threatening to remove the entire Board of Directors. If such a result were to occur, under Section 223(a) of the Delaware General Corporation Law ("DGCL"), any shareholder may call a special meeting of shareholders in accordance with the certificate of incorporation or the bylaws, or may apply to the Court of Chancery for a decree summarily ordering an election. Such an aggressive tactic will be challenging for an activist given the likely predisposition of proxy advisory firms and large institutional investors against an action that would temporarily leave a public company without a Board of Directors.

It is also worth noting that under Section 223(c) of the DGCL, if at the time of filling any vacancy or any newly created directorship, the directors then in office constitute less than a majority of the whole Board (as constituted immediately prior to any such increase), the Court of Chancery may, upon application of any shareholder or shareholders holding at least 10 percent of the voting stock at the time outstanding having the right to vote for such directors, summarily order an election to be held to fill any such vacancies or newly created directorships, or to replace the directors chosen by the directors then in office as aforesaid.

Key Takeaways: Governance provisions in a company's organizational documents, particularly in the certificate of incorporation, that limit shareholders' rights to remove directors, fill vacancies and determine the size of the Board can serve as effective activism defense tools for companies facing an activist situation. Without the power to *both* create director vacancies (via removal or expansion of the size of the Board) and fill those vacancies, an activist's power to act by written consent or call a special meeting is somewhat illusory. Companies should review their certificate of incorporation and bylaws to assess their strengths and vulnerabilities in limiting or responding to a consent solicitation or special meeting.

AI Spotlight

Corporate Criminal Liability for Artificial Intelligence

The evolution of artificial intelligence ("AI") is advancing rapidly, transforming how we live and work. Companies across a wide range of industries are racing to adopt AI to boost productivity, efficiency and profitability. Meanwhile, several U.S. regulators have already started issuing policies and rules governing the safe use of AI to help mitigate potential risks, such as fraud, discrimination and data breaches.

Questions remain, however, on how criminal law enforcement will be able to police the improper use of AI. That task will be particularly challenging where the legal violations result from AI-driven decision-making rather than intentional human actions. The Department of Justice has already begun discussing how it will approach crimes committed with AI, but who may be prosecuted where an AI system violates the law despite human developers or users having no intention to do so is still an open question.

For an in-depth discussion of how AI is reshaping the business landscape, the options available to prosecute violations of the law by AI and how you can stay ahead of emerging challenges, see our recent **article**.

Other Regulatory Updates

EU Formally Adopts Adjusted Timelines for Adoption of Sustainability Reporting Standards

On April 29, 2024, the European Council approved a Directive amending the EU Corporate Sustainability Reporting Directive ("CSRD") to extend the time limits for the adoption of sustainability reporting standards for non-EU companies, as well as for certain sector-specific sustainability reporting standards. The CSRD, which was adopted on July 31, 2023, requires companies to report on a wide range of sustainability related topics, including human rights, environmental rights, social rights and governance factors. The CSRD applies to EU companies and non-EU companies which have at least €150 million in revenue generated in the EU and at least one subsidiary or branch in the EU.

The Directive postpones the deadline for adoption of both the sector-specific European sustainability reporting standards and the standards applicable to non-EU companies by two years, shifting the deadlines from June 2024 to June 30, 2026. However, despite the extended time limits, the Directive does not prevent publication of sector-specific standards before the end of the new deadline and specifically indicates that the European Commission should adopt the sector-specific standards as soon as they are ready.

The reporting deadlines for non-EU companies under the new standards have not changed, and covered non-EU companies are currently still required to report under the CSRD starting with the fiscal year 2028. This means covered non-EU companies will have less time to consider the specific reporting standards applicable to them. Covered companies should therefore continue to closely monitor developments and consider how they will comply with the reporting standards as they are formalized over the next two years. Additionally, the European Commission may adopt sector-specific standards on a more accelerated basis, and non-EU companies may begin encountering inquiries from business partners based in the EU who will have reporting obligations prior to the fiscal year 2028 deadline.

EEOC Issues Final Regulation on Pregnant Workers Fairness Act

On April 19, 2024, the Equal Employment Opportunity Commission issued a final rule and interpretive guidance to implement the Pregnant Workers Fairness Act ("PWFA"). The PWFA requires covered employers to provide reasonable accommodations to a qualified worker's known limitations related to, affected by, or arising out of pregnancy, childbirth or related medical conditions, unless the accommodation will cause the employer an undue hardship. The final rule will take effect on June 18, 2024 and offers guidance on potential accommodations and the expansive conditions potentially covered by the PWFA. For more information on the final rule, please see our **client alert**.

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