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2023 SEC Reporting Guide

Annual Reports, Proxy Statements and Other Relevant Considerations

Aligned with your business.

Hunton Andrews Kurth LLP represents a wide variety of public companies in connection with their ongoing SEC reporting requirements and other disclosures. We also provide strategic advice to boards, management teams and investors on a wide range of corporate governance matters, including ESG.

Our public company practice is complemented by our capital markets practice, which has handled more than 910 equity and debt transactions with an aggregate value of approximately $525 billion in the past five years.

We constantly monitor trends and changes that are affecting and will affect our clients, and, at this time of year when so many companies are working on their annual reports and proxy statements, we have collected a compendium of articles regarding recent SEC reporting developments and other relevant considerations that we hope you may find useful. The index is meant to be a helpful checklist with the sections that follow being a deeper dive of the issues to be aware of this reporting season.

Our commitment to staying up-to-date on regulatory and market developments in securities, corporate governance and ESG is demonstrated in the pages that follow. Should you have any questions about any of the topics discussed herein, please do not hesitate to contact any of the authors of this guide or your regular contact at Hunton Andrews Kurth.

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Annual Reports

1. RISK FACTORS

One of the first items of business for a company preparing for its annual report is updating the risk factors. It is important to assess this dynamic area of disclosure in light of recent global events and trends and also events and trends more specific to the company that may have impacted or may in the future impact a company's business, results of operations and liquidity, creating risks not previously disclosed to investors. Such developments might include, but are not limited to:

- changing capital markets conditions, including due to rising inflation and interest rates;
- changing macroeconomic conditions, including a potential recession;
- foreign exchange rate volatility;
- supply chain disruptions;
- sanctions and the impacts of Russia's invasion of Ukraine (see below);
- cybersecurity; and
- the impact of climate change.

On May 10, 2022, the SEC posted a sample comment letter to companies regarding potential disclosure obligations related to Russia's invasion of Ukraine and the international response and the potential impact on the companies' businesses. The guidance includes a non-exhaustive list of potential impacts and issues for companies to consider when drafting their disclosures, including detailed disclosure regarding risks related to disruptions in supply chains, reputational impacts, increases in commodity prices, impacts on the availability and cost of energy and increased risk of cyberattacks by state actors or others. The guidance notes that any impacts or issues related to Russia's invasion of Ukraine may require enhanced disclosures in financial statement footnotes, MD&A or risk factors. Companies should carefully review this guidance in connection with the preparation of their annual reports and other filings, regardless of whether they have operations in Russia or Belarus.

As new risk factors are added, companies should remember the requirement to provide a summary risk factor where the section exceeds 15 pages and that risk factors that are not specific to the company should be categorized as "General Risk Factors."

Companies should also consider, to the extent any of their risk factors are no longer applicable, scaling them back. For example, existing COVID-19 risk factor disclosures should be considered in light of how the company is currently experiencing the effects of the pandemic and future anticipated effects.

2. UPDATED NON-GAAP CD&IS

On December 13, 2022, the SEC staff updated its Compliance & Disclosure Interpretations (C&DIs) with respect to non-GAAP financial measures by adding several new C&DIs and making important updates to several previously issued C&DIs.

As public companies approach the upcoming 10-K season, they should be mindful of how certain non-GAAP financial measures are presented and make sure to review their various disclosures in light of the new and updated CD&Is.

The updates are as follows:

Question 100.01 revises an existing CD&I regarding under what circumstances an adjustment, although not explicitly prohibited, can result in a non-GAAP measure that is misleading. The staff did so by expanding the discussion of under what circumstances the staff would consider a non-GAAP performance measure that excludes normal, recurring, cash operating expenses necessary to operate a registrant's business to be misleading by noting that:

- when evaluating what is a normal, operating expense, the staff considers the nature and effect of the non-GAAP adjustment and how it relates to the company's operations, revenue generating activities, business strategy, industry and regulatory environment; and
- the staff would view an operating expense that occurs repeatedly or occasionally, including at irregular intervals, as recurring.

Question 100.04 revises an existing CD&I regarding the extent to which non-GAAP adjustments would be considered individually tailored recognition and measurement methods and may cause the presentation of a non-GAAP measure to be misleading. The staff added the following non-exclusive list of examples that may be considered to be misleading:

- changing the pattern of recognition, such as including an adjustment in a non-GAAP performance measure to accelerate revenue recognized ratably over time in accordance with GAAP as though revenue was earned when customers were billed;
- presenting a non-GAAP measure of revenue that deducts transaction costs as if the company acted as an agent in the transaction, when gross presentation as a principal is required by GAAP, or the inverse;
- presenting a measure of revenue on a gross basis when net presentation is required by GAAP; and
- changing the basis of accounting for revenue or expenses in a non-GAAP performance measure from an accrual basis in accordance with GAAP to a cash basis.

Question 100.05 is a new C&DI that states that a non-GAAP measure or a particular adjustment can be misleading if not appropriately labeled and clearly described. While noting that non-GAAP measures are not always consistent across, or comparable with, non-GAAP measures disclosed by other companies (i.e., not every company that uses the same measures and makes the same adjustments needs to describe them the same way to avoid violating SEC rules), labels and descriptions still matter. The staff also notes that the following examples would violate Rule 100(b) of Regulation G:

- failure to identify and describe a measure as non-GAAP; and
- presenting a non-GAAP measure with a label that does not reflect the nature of the non-GAAP measure, such as:
  - a contribution margin that is calculated as GAAP revenue less certain expenses, labeled “net revenue;”
  - non-GAAP measure labeled the same as a GAAP line item or subtotal even though it is calculated differently than the similarly labeled GAAP measure, such as “Gross Profit” or “Sales;” and
  - non-GAAP measure labeled “pro forma” that is not calculated in a manner consistent with the pro forma requirements in Article 11 of Regulation S-X.

Question 100.06 is a new CD&I confirming, without citing specific examples, that a non-GAAP measure can be misleading even if it is accompanied by disclosure—even extensive, detailed disclosure—about the nature and effect of each adjustment made to the most directly comparable GAAP measure.

Question 102.10 is an expansion of an existing CD&I that provided a non-exclusive list of examples of what would constitute an impermissible presentation of a non-GAAP measure without the most directly comparable GAAP measure being presented with equal or greater prominence. The expanded CD&I is now broken down into three subsections.

- The full list of examples (some of which represent changes or additions to the prior guidance which may cause companies to reconsider their existing practices) of what the staff would consider non-GAAP measures that are more prominent than the comparable GAAP measures now covers the following:
  - Presenting an income statement of non-GAAP measures (i.e., a “non-GAAP income statement”).
  - Presenting a non-GAAP measure before the most directly comparable GAAP measure or omitting the comparable GAAP measure altogether, including in an earnings release headline or caption that includes a non-GAAP measure.
  - Presenting a ratio where a non-GAAP financial measure is the numerator and/or denominator without also presenting the ratio calculated using the most directly comparable GAAP measure(s) with equal or greater prominence.
  - Presenting a non-GAAP measure using a style of presentation (e.g., bold, larger font, etc.) that emphasizes the non-GAAP measure over the comparable GAAP measure.
  - Describing a non-GAAP measure as, for example, “record performance” or “exceptional” without at least an equally prominent descriptive characterization of the comparable GAAP measure.
  - Presenting charts, tables or graphs of non-GAAP financial measures without presenting charts, tables or graphs of the comparable GAAP measures with equal or greater prominence, or omitting the comparable GAAP measures altogether.

  - Providing discussion and analysis of a non-GAAP measure without a similar discussion and analysis of the comparable GAAP measure in a location with equal or greater prominence.

- The following are examples of non-GAAP disclosures that the staff would consider to be more prominent than the comparable GAAP measures:
  - Starting the reconciliation with a non-GAAP measure.
  - Presenting a "non-GAAP income statement" when reconciling non-GAAP measures to the most directly comparable GAAP measures. See Question 102.10(c).
  - When presenting a forward-looking non-GAAP measure, a registrant may exclude the quantitative reconciliation if it is relying on the exception provided by Item 10(e)(1)(i)(B) of Regulation S-K. A measure would be considered more prominent than the comparable GAAP measure if it is presented without disclosing reliance upon the exception, identifying the information that is unavailable, and its probable significance in a location of equal or greater prominence.
  - The staff stated that it considers a "non-GAAP income statement" to be one that comprises non-GAAP measures and includes all or most of the line items and subtotals found in a GAAP income statement.

3. HUMAN CAPITAL

Human capital management is an area of disclosure that has received increased attention and continued to evolve in recent years. We expect this trend to continue in this reporting season, especially given that a new proposed rule on the subject will be released in April 2023 according to the SEC's most recent Regulatory Flex Agenda.

Since the effectiveness of amendments to Item 101(c) of Regulation S-K in late 2020, the "Business" section of an annual report has required, to the extent material to an understanding of the company's business taken as a whole, a description of the company's human capital resources, including the number of persons employed by the company, and any human capital measures or objectives that the company focuses on in managing the business (such as, depending on the nature of the company's business and workforce, measures or objectives that address the development, attraction and retention of personnel).

In adopting the amendments, the SEC declined to define the term "human capital."

In responding to these principles-based disclosure requirements, the information companies provide has varied widely based on factors such as the company's actual business (i.e., how and to what degree human capital is important to the company) and the company's size. Some companies—particularly those with only a small number of employees—provide minimal information, while others take a more expansive approach that is often broadly consistent (and should be materially consistent) with ESG-related disclosures in their proxy statements and voluntarily furnished ESG reports.

Topics covered (qualitatively and quantitatively) in annual reports and proxy statements can include:

- diversity, equity and inclusion (DEI) policies and practices;
- the race, ethnicity, gender, gender identity, sexual orientation, disability status, geographic location, job type/position, age and other characteristics of a company's workforce (including both employees and "gig," contract or temporary workers);
- pay equity;
- recruitment, hiring and retention (including turnover);
- healthcare and other benefits and resources;
- health, wellness and safety;
- training and leadership development;
- employee engagement;
- union activity and collective bargaining agreements; and
- the impact of the COVID-19 pandemic on matters such as workers' health and safety, remote work policies and vaccination mandates.

The proxy statement may also contain information about how a company's board oversees human capital-related risks and opportunities, including DEI.

The variability of the responsive disclosures provided also reflects, to a certain extent, companies striking a balance between and among often competing considerations such as competitive sensitivity of information, materiality, costs and burdens of presenting information, peer reporting practices, the expectations of investors and other stakeholders (including current and prospective employees), the policies of proxy advisory firms, human capital-oriented requirements of voluntary ESG reporting guidelines and the methodologies of third-party ESG ratings companies.

While the SEC has not given any definitive indication as to what disclosures the human capital rule it is working on would require, we anticipate that, like the SEC's recent proposal regarding climate-related disclosures, the proposed requirements will be detailed, prescriptive and intended to be aligned (at least to some extent) with current voluntary reporting standards and practices. A relatively recent rulemaking petition by a group of academics requesting expanded disclosure regarding "workforce costs" in both the MD&A and the financial statements may also inform the SEC's approach to the rule-making. We will continue to monitor developments in this area.

4. CLIMATE CHANGE

In March 2022, the SEC proposed new rules that would require US public companies to disclose climate-related information in annual reports and registration statements. Unsurprisingly, given the profound impact adoption of these rules would have on public company reporting, the SEC received a staggering number of detailed and extensive comments from a wide range of supporters and detractors during the now-closed public comment period. The SEC's most recent Regulatory Flex Agenda indicates that final rules will be published in April 2023, but there can be no assurance as to when, or in what form if at all, the rules will be finalized and become effective.

If the proposed rules (or a final version of the proposed rules that maintains the same basic structure and some if not all of the same elements) become effective, standing business and financial disclosures developed pursuant to SEC rules and market practice guided by a standard of materiality would be supplemented with an almost stand-alone new set of lengthy and complex climate-related disclosures, much of which would be required without regard to management's judgment as to whether such disclosures are material or useful to investors. Among other things, the proposed rules would require reporting companies to include climate-related financial statement metrics in their annual financial statements that would be subject to audit and disclose historic greenhouse gas (GHG) emissions data which would ultimately be subject to external assurance at a level equivalent to the annual financial statements audit.

Assuming the SEC finalizes the rules during 2023, and based on the approach taken in the proposal, large accelerated filers would be required to comply with the bulk of the new requirements starting with the annual report for the fiscal year ending December 31, 2024, with additional phase-in periods for smaller companies and with respect to certain requirements. Given the scope and scale of the proposed rules, we recommend that companies monitor developments closely and begin preparations for compliance as soon as practicable. For more information about the proposed rules and a detailed summary of their structure and elements, please see our client alert.

With respect to this year's SEC filings, companies should review their existing climate-related disclosures in light of the SEC's 2010 disclosure guidance, which sets forth the SEC's view on how its existing disclosure rules—including those related to description of business, risk factors and MD&A—may require disclosure of the impacts of climate change on a company's business or financial condition without regard to whether any new rules regarding climate-related disclosures are adopted.

Companies should also consider the sample letter to companies regarding climate change disclosures the SEC's Division of Corporation Finance published in September 2021, which includes an illustrative, non-exhaustive list of comments that the SEC staff has issued to certain companies regarding their climate-related disclosures (or perceived lack thereof).

Depending on a company's industry and the degree of impact climate change has or may have on its business, a company may also want to consider implementing (or expanding) voluntary climate-related disclosures in alignment with the recommendations of the Task Force on Climate-Related Financial Disclosures (TCFD). Rising out of the "alphabet soup" of overlapping, inconsistent and potentially conflicting voluntary ESG frameworks and standards, the TCFD recommendations have emerged as the dominant international framework for climate-related disclosures. Moreover, the SEC used the TCFD as the model for the proposed rules, consistent with the approach taken by other ongoing international climate-related disclosure legislation, regulation and standard-setting initiatives.

The recommendations of the TCFD were first published in 2017 and have, more and more in recent years, been incorporated as a central plank of the voting guidelines and policies of major institutional asset managers[1] and are also encouraged by the voting guidelines of both ISS and Glass Lewis. According to the G&A Institute's most recent report, for Russell 1000 companies, the rate of publication of voluntary disclosures aligned with the TCFD recommendations increased from four percent in 2019 to 17 percent in 2020 to 34 percent in 2021, although adoption is relatively higher at larger companies and also varies widely by industry.

5. CYBERSECURITY

The SEC has continued to focus on cybersecurity in its rulemaking and its enforcement actions as an area of stated focus. In March 2022, the SEC proposed amendments to its existing rules intended to enhance disclosures for public reporting companies in order to better inform investors about a registrant's cybersecurity risk management, strategy, and governance and to provide timely notification to investors of material cybersecurity incidents. The comment period for the proposed rules ended in May 2022. The SEC's most recent Regulatory Flex Agenda indicates that a final rule will be published in April 2023, but there can be no assurance as to when, or in what form, if at all, the rule will be finalized and become effective. As we previously covered in greater detail, the proposed rule amendments would require companies:

- to disclose material cybersecurity incidents on Form 8-K;
- to provide updates in periodic reports regarding material cybersecurity incidents that were previously reported on Form 8-K, or report any individually immaterial cybersecurity incidents not previously disclosed that become material in the aggregate;
- to provide disclosure in their proxy statements and annual reports on Form 10-K regarding
  - the policies and procedures to identify and manage cybersecurity risks that companies have adopted,
  - the board of directors' oversight of cybersecurity risk, and
  - management's role and expertise in assessing and managing cybersecurity risk and implementing cybersecurity policies and procedures; and
- to include in their proxy statements or annual reports on Form 10-K disclosure regarding the specific cybersecurity expertise held by members of the board.

While these rules are not yet final, they are not entirely new and build on existing SEC rules and guidance regarding disclosure obligations with respect to cybersecurity risk management. Companies are already expected to provide proxy statement disclosures regarding the board's role in oversight of risk management of cybersecurity issues and to provide appropriately specific risk factor disclosures regarding the risk of a material cybersecurity breach, including identifying specific breaches to the extent material. Care should be taken this reporting season to ensure compliance with current expectations while preparing internally for these new enhanced disclosure requirements. A few more specific recommendations are as follows:

- **Review policies and procedures relating to cybersecurity and risk management.** Companies should ensure that they have adequate cybersecurity risk management policies and procedures in place to address their particular business needs. Companies should start reviewing and updating the policies and procedures now if they have not begun to do so already. Companies should pay particular attention to changes in their technology infrastructure, recent acquisitions and mergers, changes in the threat landscape, and lessons learned from any recent security incidents.
- **Review your incident response plans.** Review cybersecurity incident response plans in light of these new proposed rules. The incident response team should be informed of the proposed rule, including the proposed four-business day reporting requirement. The incident response plan should also have a clear escalation plan for raising significant or potentially material incidents with senior leadership and the board of directors. Additionally, senior leadership and the board should have developed criteria for determining materiality.

1 See, e.g., BlackRock, Climate Risk and the Global Energy Transition (February 2022) ("The four pillars of the TCFD governance, strategy, risk management, and metrics and targets allow companies to use a common vocabulary and disclose to investors standardized information, in both data and narrative form. While this is a voluntary, admittedly complex, and evolving reporting recommendation, we believe that companies that consider all aspects of the TCFD framework and provide suitable detail will be in a better position to maintain investor confidence and support.").

- **Review board cybersecurity expertise and preparedness.** Review and assess each member of the board of directors' skills and experience and consider enhancing related disclosures on cybersecurity expertise. Consider whether the board is prepared to oversee the cybersecurity and risk management plans of the company. Does the board have access to the necessary information? Determine whether the full board, or a subset of the board, will be primarily responsible for oversight, and ensure that they have been properly trained and approve of the company's policies and procedures.

6. ITRA DISCLOSURE

In response to Russia's invasion of Ukraine, the US government has imposed a series of additional sanctions and export control measures since early March 2022. Russia's invasion of Ukraine has had, and may continue to have, far-reaching consequences on the businesses of SEC-reporting companies as multiple Russian entities and individuals have been designated as subject to Executive Order No. 13382, including the Federal Security Service of the Russian Federation, bringing them within the scope of the disclosure requirements of the Iran Threat Reduction and Syria Human Rights Act of 2012 (ITRA).

Public companies may have disclosure responsibilities related to the direct or indirect impact that Russia's invasion of Ukraine has had or may have on their businesses. Specifically, ITRA requires Form 10-K and Form 10-Q (or Form 20-F, in the case of foreign private issuers) disclosure if, during the period covered by the report, the company or any affiliate, among other things, knowingly conducted any transaction or dealing with any person for whom the property and interests in the property are subject to an applicable sanction. If a company is required to report its connection to Russia in its annual or quarterly report, it must also separately file with the SEC, at the same time it files its annual or quarterly report, a notice that such disclosure is contained in the report.

To assist public companies in assessing their disclosure obligations, in May 2022 the SEC published a sample letter to companies regarding disclosures pertaining to Russia's invasion of Ukraine and related supply chain issues. The sample letter reinforces companies conducting any business or transaction with Russia or Russian entities or individuals to assess whether they need to make any potential disclosure or modifications to their disclosure controls and notice requirements under ITRA.

Proxy Statements, Corporate Governance and Executive Compensation

1. NEW UNIVERSAL PROXY RULES

On November 17, 2021, the SEC adopted amendments to the proxy rules under Rule 14a-19 to require the use of a universal proxy card in proxy contests for most public companies. The new rules are effective for shareholder meetings held after August 31, 2022. Under the new rules, companies and dissidents must use a universal proxy card in contested elections that includes the names of all director nominees, including the company and dissident nominees, as well as any other shareholder nominees resulting from proxy access. This will allow shareholders to choose some nominees from the company's slate and some nominees from the activist's slate, rather than having to choose between either the company's slate or the activist's slate. The new rules require:

- dissidents to notify the company of their intent to solicit proxies and the names of their nominees no later than 60 calendar days before the anniversary of the previous year's annual meeting;
- companies to notify dissidents of the names of their nominees no later than 50 calendar days before the anniversary of the previous year's annual meeting;
- each side in a proxy contest to refer shareholders to the other party's proxy statement for information about the other party's nominees;
- certain formatting and presentation requirements for proxy cards, including the requirement that director nominees be listed in alphabetical order by last name; and
- director nominee consent to be named in any proxy statement, not just the company's proxy statement.

Proxy Disclosure

Under the new rules, a dissident is required to file its definitive proxy statement at least 25 calendar days before the shareholder meeting or five calendar days after the company files its definitive proxy statement, whichever is later. If the dissident fails to file its proxy statement within the prescribed window, it will be precluded from soliciting proxies and the company will have the option to circulate a new proxy excluding the dissident's director nominees. The dissident must disclose in the proxy statement that the dissident intends to solicit holders of at least 67 percent of the voting power of the shares entitled to vote at the meeting.

Companies are now required to disclose in the company proxy statement, for contested and uncontested elections, the deadline for receiving notice of a dissident's nominees. Given the enhanced scrutiny on individual nominees that is likely to result from the universal proxy rule, companies and dissidents alike should ensure that their proxy disclosure effectively conveys the skills and attributes of each nominee.

Bylaws Considerations

In response to the universal proxy rules, companies should consider several changes to their bylaws, particularly their nomination and advance notice procedure bylaws. See our alert on the subject for further details.

2. OFFICER EXCULPATION UNDER THE DGCL

Effective August 2022, Section 102(b)(7) of the Delaware General Corporation Law (DGCL) was amended to allow Delaware corporations to limit or eliminate personal liability of certain enumerated officers for breaches of their fiduciary duty of care. The DGCL has long authorized exculpation for directors of Delaware corporations from personal liability for monetary damages for breaches of their duty of care, but the same protections were not available for officers of these corporations until this amendment was enacted. As with director exculpation, officer exculpation is available only for breaches of the duty of care. Neither the director nor officer exculpation provisions cover: (i) breaches of the fiduciary duty of loyalty; (ii) acts or omissions not in good faith or that involve intentional misconduct or a knowing violation of the law; or (iii) receipt of an improper personal benefit.

Although officer exculpation is now permitted, it must be noted that officers are not entitled to the same broad protection afforded to directors. Specifically, officer exculpation is permitted only in direct claims, meaning claims brought directly by stockholders in their capacity as stockholders. Officer exculpation is disallowed in claims brought by or in the right of the corporation, including stockholder derivative claims, whereas director exculpation is not subject to this limitation. Typically, derivative lawsuits must be authorized by the board, which may provide a level of comfort to corporate officers, but Delaware law allows stockholders to bring derivative lawsuits if they can demonstrate that the board is incapable of objectively considering the litigation demand. To illustrate, this means that officers may be shielded from personal monetary liability in a stockholder suit claiming that the officers breached their duty of care by negligently preparing corporate disclosures. Notably, however, officers would not be shielded from liability in a derivative suit brought in the name of the corporation relating to a corporate crisis, for example. The amended law also preserves the board of directors' ability to hold officers liable for breaches of the duty of care. Please see our alert for further details about the new Delaware law.

In order to take advantage of officer exculpation under Section 102(b)(7), Delaware corporations must include an exculpation clause in their certificates of incorporation, either by including the clause in the original certificate or by adopting an amendment to the certificate. Pursuant to Section 242(b) of the DGCL, in order to amend the certificate of incorporation, the amendment must be approved by the corporation's board of directors and a majority of the corporation's stockholders at an annual or special meeting of stockholders (unless the certificate of incorporation states otherwise). In 2022, ISS and Glass-Lewis recommended voting for officer exculpation amendments where the amendments were presented as standalone proposals. In contrast, these proxy advisory firms either did not take a specific stance on officer exculpation or recommended a vote against the amendments where they were included in bundled proposals. Further, Glass-Lewis and ISS have stated in their 2023 voting policies that officer exculpation amendments would be evaluated on a case-by-case basis, with Glass Lewis taking a slightly more open-minded approach noting that, "some protection from liability is reasonable."

With 2023 proxy season fast approaching, Delaware corporations seeking to add this protection should note that a preliminary proxy filing is required for a proposal to amend the certificate of incorporation to include an officer exculpation provision, and should incorporate an additional associated waiting period into their 2023 annual meeting filings timeline.

3. BOARD DIVERSITY

As compared to some other ESG topics—such as climate change and human capital management elsewhere in this guide—that companies need to keep in mind when they are thinking about disclosure in their SEC filings, when it comes to board diversity, the range of potential disclosures is far less open-ended.

As a baseline, Regulation S-K Items 401(e) and 407(c)(2)(vi)—SEC rules that apply to all proxy statements—require a brief discussion of the specific experience, qualifications, attributes or skills that led to the conclusion that a person should serve as a director, as well as a description of how the board implements any policies it follows with regard to the consideration of diversity in identifying director nominees. In Regulation S-K CD&I 116.11 published in 2019, the SEC staff indicated that it would expect, as part of disclosure responsive to these long-standing requirements, that the existence and consideration of self-identified diversity characteristics would also be disclosed.

Companies listed on Nasdaq are also subject to a rule that was approved by the SEC in 2021 and requires public disclosure, on an annual basis by December 31 of each year, of self-identified board diversity characteristics on a director-by-director basis (but without necessarily naming which director has which characteristic) using a standardized matrix template. For NYSE-listed companies considering whether to disclose board diversity on an aggregate level (if at all), it is worth noting that the voting guidelines and policies of proxy advisory firms and institutional investors do not generally indicate any objection to board diversity disclosure provided on an aggregated basis instead of director-by-director.

Companies also need to consider the potential implications of the number or relative proportion of diverse directors on their boards under voting guidelines and policies of institutional investors and proxy advisory firms, as well as similar requirements under the Nasdaq rule (which remains subject to legal challenge on the US Court of Appeals for the Fifth Circuit) and the laws of California (which remain subject to legal challenge on state constitutional grounds) and various other states.

In this regard, the Nasdaq rule requires listed companies[2] to have or explain why they do not have:

- at least one director who self-identifies as diverse (either female or an underrepresented minority) by December 31, 2023; and
- at least two directors who self-identify as diverse (either female or an underrepresented minority) by December 31, 2025, and, for companies listed on the Nasdaq Capital Market by December 31, 2026.

While structured as an indirect "comply or explain" requirement, this element of the Nasdaq rule still puts direct pressure on companies to have a certain number of diverse directors in order to avoid including potentially undesirable disclosure explaining their reasons for deviating from what is fast becoming (or has already become) the norm. The voting policies of the major proxy advisory firms go one step further by threatening potential consequences for directors on boards that do not have (or have not disclosed sufficient information for an investor to determine whether they have) a sufficient number or percentage of diverse directors. See "Updates to ISS/GlassLewis Policies" elsewhere in this guide. Many institutional investors also have policies and guidelines along the lines (although not necessarily identical) to those of ISS and Glass Lewis.

Looking forward, the SEC will propose a new board diversity disclosure rule in October 2023, according to its most recent Regulatory Flex Agenda. However, notwithstanding whether the SEC rulemaking advances and without regard to the ultimate outcome of litigation challenging the Nasdaq rule or any state law, the bottom line is that board diversity remains at or near the top of the agenda in many public company boardrooms and public disclosure about board diversity has been increasing. These trends show no signs of stopping. According to Spencer Stuart's most recent analysis of S&P 500 company disclosures during the period from May 1, 2021 to April 30, 2022, 93 percent of boards disclosed their racial or ethnic composition, up substantially from 60 percent in 2021, and 41 percent of those boards identified directors from historically underrepresented groups by name (for those who volunteered to self-identify) up from 28 percent in 2021. Moreover, Spencer Stuart also found that 72 percent of new directors added to boards in 2022 were diverse, split evenly between women and members of underrepresented groups, although the growth in the relative percentage of diverse directors continues to be incremental: women comprised 32 percent of directors in total in 2022, up from 30 percent in 2021 and 28 percent in 2020, and members of underrepresented racial or ethnic groups comprised 22 percent of directors in total in 2022, up from 21 percent in 2021. Smaller companies are not far behind.

4. BOARD LEADERSHIP AND OVERSIGHT

After the 2022 proxy season, the SEC staff sent substantially similar comment letters to at least two dozen different companies requesting the expansion of proxy disclosures provided in response to Item 407(h) of Regulation S-K, which requires a "brief[]" description of a company's board leadership structure (i.e., if the role of chair and CEO are split or if the board has a lead independent director), why the company has determined this leadership structure is appropriate and the extent of the board's role in risk oversight.

The comment letters did not target any particular industry or leadership structure and generally covered the following:

- Please expand your discussion of the reasons you believe that your leadership structure is appropriate, addressing your specific characteristics or circumstances. In your discussion:
  - please also address the circumstances under which you would consider having the chair and CEO roles filled by a single individual, when shareholders would be notified of any such change, and whether you will seek prior input from shareholders; and
  - how the experience of the lead independent director is brought to bear in connection with your board's role in risk oversight.

2 Subject to additional flexibility for Smaller Reporting Companies and Foreign Issuers, which can meet the diversity objective by including two female directors, and for all companies with five or fewer directors, which can meet the diversity objective by including one diverse director.

- Please expand upon the role that your lead independent director plays in the leadership of the board. For example, please enhance your disclosure to address whether or not your lead independent director may:
  - represent the board in communications with shareholders and other stakeholders;
  - require board consideration of, and/or override your CEO on, any risk matters; or
  - provide input on design of the board itself.
- Please expand upon how your board administers its risk oversight function. For example, please disclose:
  - why your board elected to retain direct oversight responsibility for particular risks, rather than assign oversight to a board committee;
  - the timeframe over which you evaluate risks (e.g., short-term, immediate-term or long-term) and how you apply different oversight standards based upon the immediacy of the risk assessed;
  - whether you consult with outside advisors and experts to anticipate future threats and trends, and how often you re-assess your risk environment;
  - how the board interacts with management to address existing risks and identify significant emerging risks;
  - whether you have a Chief Compliance Officer and to whom this position reports; and
  - how your risk oversight process aligns with your disclosure controls and procedures.

Companies that received one of these letters generally responded that they would continue to evaluate, and appropriately expand, the relevant discussion in future proxy statements even if the company believed that its current proxy disclosures were fully compliant with Item 407(h) of Regulation S-K. Companies that did not receive one of these letters may also want to evaluate and potentially expand their disclosures. For some companies, it may make sense to provide more company-specific detail about the board's role in risk oversight, especially in light of the enhanced requirements in this regard contemplated by the SEC's pending proposals regarding climate-related risks and cybersecurity risks, which are discussed in more detail elsewhere in this guide.

5. SHAREHOLDER PROPOSALS

2022 was a robust year for shareholder proposals under Exchange Act Rule 14a-8, with the overall number of proposals submitted (driven by environmental and social proposals) continuing to rise even as the passage rate declined.

The higher volume of proposals was in no small part driven by a less accommodating stance taken by the SEC staff to "no-action" requests to exclude shareholder proposals from their proxy statements, as embodied by Staff Legal Bulletin No. 14L published in November 2021. This bulletin rescinded prior bulletins, restated the staff's focus and narrowed the circumstances under which a proposal could be viewed as falling within the "ordinary business" and "micromanagements" exclusions under Rule 14a-8(i)(7) or the "economic relevance" exclusion under Rule 14a-8(i)(5), in each case in ways that have made and are expected to continue making it harder for companies to exclude environmental and social proposals in particular.

It is also worth noting that there was less support from institutional investors for environmental and social proposals which were considered unduly constraining on management or overly prescriptive as to information sought or timeframes or that failed to recognize the progress made such that companies had largely met the ask of the proposal, with BlackRock citing these as factors as driving the decline in its support for environmental and social proposals in the US from 43 percent in 2021 to 24 percent in 2022.

Looking forward, the SEC has proposed amendments to Rule 14a-8 that would further narrow the grounds for companies to exclude a shareholder proposal on the basis of substantial implementation, duplication and resubmission of a prior proposal and thereby drive further future increases in shareholder proposals. For further information, please see our client alert. The SEC indicated in its latest Regulatory Flex Agenda that the proposed amendments are scheduled to be finalized in October 2023, but there is no assurance as to when, or in what form if at all, any amendments to Rule 14a-8 will become effective.

To help illustrate these trends, we note the following results of research conducted by The Conference Board and ESG data analytics firm ESGAUGE on shareholder proposals in the 2022 proxy season through July 2022:

- Proposals submitted—813 in the Russell 3000 and 642 in the S&P 500—were at their highest level in five years.
- Of the proposals in the Russell 3000 in 2022, 471 (or 57.9 percent) related to environmental and social policy, up from 403 in 2021 (50.9 percent), 339 in 2020 (45.9 percent) and 328 in 2018 (44.7 percent). By comparison, there were 41 executive compensation-related proposals in 2022, down from 42 in 2021 and 54 in 2020 and corporate governance-related proposals were down to 258 in 2022 from 305 in 2021 and 317 in 2020.
- Of the 555 voted proposals in the Russell 3000, 82 (or 14.8 percent) received majority support, down from 113 in 2021 (23.5 percent) although up from 68 in 2020 (14.7 percent). Of the 437 voted proposals in the S&P 500, 46 (or 10.5 percent) received majority support, down from 59 in 2021 (16.4 percent) although up from 36 in 2020 (10.2 percent).
- The SEC staff rejected no-action relief requests to exclude 106 proposals out of 233 requests in the Russell 3000 while granting 71 requests, as compared to 58 rejections out of 258 requests in 2021 with 136 requests granted. In the S&P 500, the SEC staff rejected no-action relief requests to exclude 94 proposals out of 200 requests while granting 59 requests, as compared to 49 rejections out of 211 requests in 2021 with 112 requests granted.

6. UPDATES TO ISS/GLASS LEWIS POLICIES

In December 2022, proxy advisory firms Institutional Shareholder Services (ISS) and Glass Lewis published updates to their voting guidelines for the 2023 proxy season. The ISS policy changes apply for shareholder meetings held on or after February 1, 2023, and the Glass Lewis policy changes apply for shareholder meetings held on or after January 1, 2023. Additionally, Glass Lewis published its 2023 Environmental, Social & Governance (ESG) Initiatives Policy Guidelines, addressing ESG-related shareholder proposals. Notable updates include the following:

Board Diversity

ISS. ISS's policy on board gender diversity will be extended from Russell 3000 and S&P 1500 companies to all US companies for the 2023 proxy season. ISS will generally recommend against the chair of the nominating committee if there are no female directors on a company's board of directors.

Glass Lewis. In its recent policy updates, Glass Lewis extended its consideration of board diversity to focus on demographic and ethnic diversity. Beginning in 2023, Glass Lewis will generally recommend against the chair of the nominating committee of a Russell 1000 company if the board of directors does not have at least one director from an underrepresented community. Glass Lewis also extended its existing policies regarding board diversity disclosure from S&P 500 companies to Russell 1000 companies. In particular, Glass Lewis may recommend voting against the chair of the nominating and/or governance committee of a Russell 1000 company that fails to adequately disclose (i) individual or aggregate racial/ethnic minority demographic information for its directors and (ii) the director diversity and skills categories tracked by Glass Lewis.

See "Board Diversity" elsewhere in this guide for further details.

Officer Exculpation

Effective August 1, 2022, the Delaware General Corporation Law was amended to permit a corporation's certificate of incorporation to include a provision eliminating or limiting the monetary liability of certain officers for a breach of the fiduciary duty of care, which protection was previously only available to directors.

ISS. Departing from its recommendation in 2022 that shareholders vote in favor of such an amendment, ISS's updated guidelines state that ISS will review officer exculpation proposals on a case-by-case basis, taking into consideration the stated rationale for the proposal.

Glass Lewis. Glass Lewis similarly walked back its 2022 policy recommending that shareholders vote in favor of officer exculpation provisions in a company's certificate of incorporation. In its updated policy, Glass Lewis indicated that it will evaluate such proposals on a case-by-case basis but will generally recommend that shareholders vote against such proposals unless the provision is reasonable, and the board of directors provides a compelling rationale for its adoption.

See “Officer Exculpation under DGCL” elsewhere in this guide for further details.

Board Accountability for Climate-Related Issues

ISS. In 2022, ISS adopted policies applicable to companies that are significant GHG emitters, stating that ISS would recommend against the chair of the responsible committee if ISS determined that the company was not taking the “minimum steps” needed to understand, assess and mitigate risks related to climate change. The minimum steps include detailed disclosure of climate-related risks and appropriate GHG reduction targets. In its 2023 updates, ISS has adopted a stricter view of what constitutes appropriate GHG reduction targets, defining them as “medium-term GHG reduction targets or Net Zero-by-2050 GHG reduction targets for a company’s operations (Scope 1) and electricity use (Scope 2),” and indicating that such targets should cover the vast majority (i.e., 95 percent) of the company’s direct emissions.

Glass Lewis. Glass Lewis expects companies with material exposure to climate risk stemming from their own operations to provide thorough climate-related disclosures in alignment with the recommendations of the Task Force on Climate-Related Financial Disclosures (TCFD) and expects the board of directors of such companies to have explicit and clearly defined oversight responsibilities over climate-related issues. If the disclosures or the board oversight are found absent or lacking, Glass Lewis may issue a negative vote recommendation against the responsible directors.

See “Climate Change” elsewhere in this guide for further details.

Board Oversight of Environmental and Social Issues

Glass Lewis. In 2022, Glass Lewis indicated that it would generally recommend voting against the chair of the nominating and/or governance committee of any S&P 500 company that failed to provide explicit disclosure about the role of the board of directors in overseeing environmental and social issues. Beginning in 2023, Glass Lewis will extend this policy to cover Russell 1000 companies.

Problematic Governance Structures

ISS. Beginning in 2023, ISS will issue a negative vote recommendation against directors at all companies with unequal voting right structures, removing the previous exception for established companies. Unequal vote structures include high/low vote stock, classes of shares that are not entitled to vote on all the same ballot items or nominees and stock with time-phased voting rights. This policy is subject to exceptions, including (i) newly public companies with a sunset provision of no more than seven years from the date of going public, (ii) limited partnerships and the operating partnerships of REITs, (iii) companies where the super-voting shares represent less than five percent of the total voting power and (iv) companies where there is sufficient protection for minority shareholders.

In addition, ISS will recommend against directors of newly public companies if the company’s bylaws or certificate of incorporation contains provisions that are materially adverse to shareholder rights, such as supermajority vote requirements to amend the bylaws or certificate of incorporation, a classified board structure or certain other “egregious” provisions. Under the prior guidelines, ISS would consider exceptions where there was a “reasonable” sunset provision attached to such a provision but, beginning in 2023, ISS has replaced “reasonable” with a seven-year sunset requirement. The seven-year sunset provision applies to all companies holding their first annual shareholder meeting as a public company after February 1, 2015.

Compensation Disclosure

ISS. ISS did not make any significant changes to its voting guidelines covering executive compensation matters for the 2023 proxy season, but it did include several updates to its FAQs relating to executive compensation. For example, ISS expanded the factors it considers when reviewing pay-for-performance disclosures to include the complexity of the compensation program, any risks associated with the pay program design, the issuer’s financial or operational results relative to peers, and recent changes to the pay program or forward-looking commitments. The proxy advisory firm also clarified that, while it believes transition pay for a CEO is necessary, it should be temporary, and the CEO’s compensation should normalize after the CEO is onboarded. ISS also noted that it will view an issuer’s clawback policy more favorably if the policy is triggered with respect to both time-based and performance-based vesting.

ISS has updated its problematic pay practices, the existence of which will cause ISS to issue a negative vote recommendation on the say-on-pay vote, to include severance payouts where the termination is not clearly disclosed as involuntary (i.e., a termination without "cause" or resignation for "good reason"). With this in mind, companies should avoid any attempts to put a positive spin on an executive's involuntary departure in proxy statements.

Glass Lewis. Glass Lewis modified its position on performance-based awards within a company's long-term incentive offerings. In the past, Glass Lewis recommended that a minimum of 33 percent of an issuer's long-term incentives be performance-based. Beginning in 2023, Glass Lewis has raised this floor and recommends that performance-based awards constitute no less than 50 percent of an issuer's long-term incentives. A lower percentage of performance-based awards will raise concerns from Glass Lewis but will not trigger a negative vote recommendation on the say-on-pay vote unless there are other related issues with the issuer's long-term incentive program.

SEC Rules Governing Proxy Advisors

In July 2020, the SEC adopted amendments to Rules 14a-1(1), 14a-2(b) and 14a-9 to enhance the transparency of information that proxy advisory firms, such as ISS and Glass Lewis, were providing to investors. These amendments established that, absent an exemption, voting advice issued by proxy advisory firms constitutes a solicitation under the proxy rules and that failure to disclose this information would constitute a violation of the proxy rules.

In July 2022, the SEC rescinded certain conditions that proxy advisors would have to satisfy for their voting recommendations to qualify for an exemption from the proxy information and filing requirements. Under the amended rules, proxy advisors no longer have to (i) make the voting advice available to the subject company at or before the time such advice is disseminated to the proxy advisor's clients or (ii) provide a mechanism by which the proxy advisor's clients can reasonably be expected to become aware of the subject company's written responses to such voting advice to qualify for an exemption.

7. NEW PAY-VERSUS-PERFORMANCE RULES

On August 25, 2022, the SEC adopted long-awaited rules addressing pay-versus-performance, implementing the requirements of the Dodd Frank Act, requiring companies to disclose both quantitatively and qualitatively, in both tabular and narrative formats, the relationship between executive compensation and the company's financial performance. The purpose of the rule is to include information that shows the relationship between executive compensation actually paid and the financial performance of the company, taking into account any change in the value of the shares of stock and dividends of the company and any distributions. The new disclosure will draw from the presentation of the year's total compensation to its principal executive and financial officers and other highest-paid executives in the "Summary Compensation Table" required under Item 402 of Regulation S-K, with some recalculations of those amounts, and provide some comparative information with respect to the performance of the company's peers. Companies with fiscal years ended December 31, 2022 will be required to include pay v. performance disclosures within the proxy and information statements they file in March – June 2023. The rules do not apply to emerging growth companies, foreign private issuers and registered investment companies. The rules do apply to smaller reporting companies, but scaled disclosure is permitted.

More specifically, companies must present tabular disclosure of the following items for the company's five most recently completed fiscal years, provided that companies may provide disclosure for the three years instead of five years in the first proxy statement:

- The Summary Compensation Table measure of total compensation for the principal executive officer (PEO).
- Table must disclose "compensation actually paid" for the PEO.
- The average Summary Compensation Table measure of total compensation for the other named executive officers (NEOs).
- A measure reflecting the average "compensation actually paid" to the NEOs.
- The company's total shareholder return (TSR).
- TSR for the company's peer group.
- The issuer's net income.
- A "Company-Selected Measure" of financial performance.

In addition, companies must provide a clear narrative, a graphical or combined narrative, and a graphical description of the relationship between (i) executive compensation actually paid and the company's TSR, (ii) the company's TSR and peer group TSR, (iii) executive compensation actually paid and net income, and (iv) executive compensation actually paid and the Company-Selected Measure. In addition, a company is required to report a list of three to seven performance measures that it deems are most important financial measures in linking executive compensation actually paid to the company's NEOs during the past fiscal year to company performance.

Smaller reporting companies are exempt from disclosing the peer group TSR and Company-Selected Measure and must disclose all other items only for the three most recently completed fiscal years. Companies may provide the disclosure for three years instead of five years in the first filing in which they provide pay-versus-performance disclosure.

8. NEW CLAWBACK RULES

On October 26, 2022, the SEC adopted new executive compensation "clawback" rules, fulfilling its 2010 mandate under the Dodd-Frank Wall Street Reform and Consumer Protection Act. The final rules direct national stock exchanges (i.e., Nasdaq and the NYSE) to establish listing standards requiring listed companies to develop and implement written policies providing for the recovery of erroneously awarded incentive-based compensation, meeting the standards specified by Rule 10D-1 under the Exchange Act. While the exact date companies must comply with the new rules is not currently known because the stock exchanges have not yet published applicable listing standards, given the prescriptive detail contained in the final rules from the SEC, companies can begin preparing now with reasonable certainty regarding their new obligations with the expectation that companies will need to adopt clawback policies by the end of 2023 or in early 2024.

A few current action items are:

- Review your current clawback policy (if any) to determine whether changes will likely be required.
- Review existing contractual arrangements and incentive compensation plans to determine whether compliance with the soon-to-be implemented (or revised) clawback policy would create any conflicts with existing contracts, such as executive employment agreements, equity incentive awards, indemnification agreements, etc.
- Consider the effects of the soon-to-be implemented (or revised) clawback policy on severance policies and separation agreements.

Notably, unlike many existing clawback policies that only apply to officers who actually engaged in fraud or misconduct related to financial statements and provide companies with some degree of discretion in determining when and whether to pursue enforcement, the new rules generally require (subject to very limited exceptions) companies to clawback compensation erroneously received by any executive officer in connection with any "Little r" restatements (i.e., financial restatements that are not deemed material errors and do not require a full restatement of previously issued financial statements), as well as "Big R" restatements (i.e., financial restatements that are deemed material errors and do require a full restatement of previously issued financial statements, as well as immediate Form 8-K disclosure to the effect that the previously issued financial statements can no longer be relied upon).

Under corresponding amendments to other SEC rules under the Exchange Act, listed companies will, once the applicable listing standards become effective, be required to (i) file their clawback polices as exhibits to their annual reports and (ii) provide new disclosures about such policies and their implementation and effects in their annual reports on Form 10-K and proxy statements, including indicating with new checkboxes on the cover pages of Forms 10-K, 20-F and 40-F whether the financial statements included in the filings reflect a correction of an error to previously issued financial statements and whether any such corrections are restatements that required a recovery analysis. It should be noted that this new rule applies to both "Little r" restatements, which typically are not disclosed or reported as prominently as "Big R" restatements, consistent with the fact that both types of restatements will need to be covered under any compliant clawback policy.

A detailed summary of the new rules can be found in our alert on the subject along with some further thoughts regarding their implications.

9. SAY-ON-FREQUENCY

The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 requires public companies to solicit shareholder preference on the frequency of the say-on-pay vote, which can take place annually, every two years or every three years. Although the say-on-frequency vote is nonbinding and advisory in nature, companies must provide shareholders the opportunity to vote on the frequency at least once every six years. This requirement first became effective during the 2011 proxy season, so many companies will be required to conduct the say-on-frequency vote again in their 2023 proxy statements.

Companies conducting the say-on-frequency vote must include on their proxy card an option to vote for one, two or three-year periods between say-on-pay votes or to abstain from voting. Companies should note the current frequency of the say-on-pay vote, state that the shareholder vote is advisory and nonbinding, provide the date of the next scheduled say-on-pay vote and note that the company is required to conduct the say-on-frequency vote every six years.

Within four business days following the shareholder meeting, the company must file an Item 5.07 Form 8-K announcing the results of the say-on-frequency vote and provide the number of votes cast for the annual, two-year, three-year or abstention options. Further board action is still required before the frequency that will apply to future say-on-pay votes becomes effective. No later than 150 calendar days after the shareholder meeting (but no later than 60 days prior to the deadline for shareholder proposals for the next year), the company must amend the Item 5.07 Form 8-K to disclose the decision of the board of directors regarding the frequency of future say-on-pay votes. Failure to disclose the frequency decision within the prescribed timeline may affect the company's Form S-3 eligibility.

10. PAY RATIO UPDATES

Item 402(u) of Regulation S-K requires public companies to disclose (i) the median of the annual total compensation of all employees, excluding the company's CEO, (ii) the annual total compensation of the CEO and (iii) the ratio of the median employee's compensation to that of the CEO. This requirement has been in place for several years; however, there are a number of issues companies should consider this year while preparing these mandatory disclosures.

To comply with this disclosure requirement, companies must calculate their median annual total employee compensation every three years. However, companies must also assess annually whether a change in employee population or employee compensation arrangements would significantly alter the reported pay ratio. If a company reasonably believes that the pay ratio would be affected by such changes, it must perform new median employee calculations for the affected year instead of relying on the previous year's calculations. Further, companies that use the same median employee in their calculations must disclose in their proxy statements that the same median employee was used in the calculation and disclose why they believe that no change has occurred that would significantly affect the pay ratio.

With a potentially challenging economic backdrop in 2022 and 2023, companies may have to consider how to incorporate furloughed employees into the median employee calculation. In analyzing whether to include any furloughed employees, companies should examine the facts and circumstances surrounding the furlough to determine whether furloughed employees should still be considered employees as of the determination date. The SEC has not provided much guidance on how companies should make this determination; however, the instructions to Item 402(u) note that permanent employees on unpaid leave are considered employees for purposes of the calculation. If it is determined that furloughed employees should be included in the calculation, companies must then consider whether to annualize the compensation of such employees. Annualization is permitted for full-time and part-time employees employed for less than the full fiscal year, but annualization is not permitted for temporary or seasonal employees.

Companies should also analyze the effect of any employee population changes on the availability of the de minimis exception to Item 402(u)(4)(ii). The de minimis exception allows the exclusion of all non-US employees for purposes of the median employee calculation if these excluded employees do not make up more than five percent of the company's employee population. Companies may also elect to include all such non-US employees. If non-US employees constitute more than five percent of a company's workforce, the company may exclude up to five percent of its total non-US employees; however, if any employees in a particular jurisdiction are excluded from the calculation, all employees in that jurisdiction must be excluded. Finally, if more than five percent of a company's total workforce is concentrated in a non-US jurisdiction, the company is not permitted to exclude these employees under the de minimis exception, although it may be able to rely on the data privacy exception to exclude these employees from its median employee compensation calculation.

Additionally, companies that have recently completed mergers or acquisitions should also consider whether new employees should be included in the median employee calculation. Employees who became part of a company's workforce during the year in which a merger or acquisition became effective may be excluded, but the company must disclose the number of employees omitted. Relatedly, companies should consider any changes in compensation policies, such as special bonuses paid only to certain employees, and any changes in employee compensation structure.

Other Ongoing Requirements and Considerations

1. IMPACT OF INFLATION REDUCTION ACT EXCISE TAX ON STOCK BUYBACKS

a. Delay in SEC Rulemaking

The Inflation Reduction Act of 2022 (IRA), which was signed into law by President Biden on August 16, 2022, contains certain changes in corporate tax law as part of a package of measures designed to address climate change and energy concerns of the United States. To help fund some of these measures and for other policy purposes, the IRA imposes a non-deductible one percent excise tax on repurchases of the stock of US publicly traded corporations and certain non-US publicly traded corporations which occur after December 31, 2022.

On December 7, 2022, the SEC reopened the comment period for the share repurchase proposal initially released in December 2021 (before the IRA was signed into law) to allow for further consideration in light of the economic effects of the excise tax. The SEC also published additional information and analysis with respect to such effects. The initial proposal, if adopted, would have profound effects on current practices by, among other things, requiring issuers to publicly report all share repurchases within one business day on new Form SR. The SEC's most recent Regulatory Flex Agenda indicates that a final rule will be published in April 2023, but there can be no assurance as to when, or in what form if at all, the rule will be finalized and become effective.

b. Convertible Securities

One potential implication of the excise tax that was introduced in the IRA is on certain call transactions often entered into in connection with convertible securities offerings—either a capped call or bond hedge and warrant. These call transactions can be closed out via physical settlement, cash settlement or net share settlement. A call transaction that is settled by delivery of shares of common stock (i.e., physical settlement or net share settlement) appears to be subject to the excise tax. The excise tax would be levied against the fair market value of the shares of common stock delivered to the company upon settlement of the call transaction. However, under an applicable netting rule, the value of the settled shares may be offset for purposes of the excise tax by the value of shares issued upon conversion of the securities (or any other issuance of common stock), provided that the conversion (or other issuance) occurs within the same tax year as the settlement of the call transaction.

If settlement of the call transaction and the security conversion (or other issuance) do not occur within the same tax year, then no netting would be permitted, and the excise tax would apply to the full value of the shares delivered in the call transaction. Absent additional guidance from the Internal Revenue Service (IRS), there is some question as to whether a cash settlement of the call transaction would be treated as the economic equivalent of a stock redemption for these purposes that is also subject to the excise tax (or whether the netting rule would apply). IRS guidance is expected to further define and clarify the scope of the new excise tax. However, the timing for release of that guidance currently remains uncertain. We will continue to monitor this area of interest to companies that have issued (or are considering issuing) convertible securities.

2. NEW RULE 10B5-1 PLAN RULES

In December 2022, the SEC unanimously approved a final rule adopting several significant amendments to the affirmative defense from insider trading liability contained in Rule 10b5-1 under the Exchange Act and related rules that will require significant additional public disclosures by insiders and issuers. The final rule reflected several notable changes to the requirements contemplated by the initial proposal made by the SEC in December 2021, which combine to make the final rules less prescriptive and restrictive (particularly for issuers)[3] than many had feared, but several long-standing practices in this important area will still need to be reconsidered and adjusted going forward.

The major changes effected pursuant to the new rules are:

- new mandatory "cooling-off" periods for 10b5-1 plans;
- new prohibitions on "overlapping" 10b5-1 plans;
- new limitations on more than one "single-trade" 10b5-1 plans per 12-month period;
- a new requirement to act in good faith with respect to 10b5-1 plans in addition to the existing requirement that all 10b5-1 plans be entered into in good faith;
- new requirements for issuers to make quarterly disclosures about the operation and implementation of 10b5-1 plans and to file their insider trading polices (if any) as exhibits to their annual reports; and
- a new checkbox on Form 4 and Form 5 indicating whether a reported transaction was effected pursuant to a 10b5-1 plan.

The new rules and requirements take effect:

- on February 27, 2023 with respect to the amendments to Rule 10b5-1;
- on April 1, 2023 with respect to changes applicable to reporting under Section 16 of the Exchange Act; and
- in SEC filings that cover the first full fiscal period that begins on or after April 1, 2023 (or October 1, 2023 for smaller reporting companies) with respect to changes applicable to other Exchange Act reporting and disclosure requirements.

For further information, please see our client alert discussing the new rules, some of their potential implications and steps companies can be taking now to prepare.

3. EDGAR SUBMISSION OF "GLOSSY" ANNUAL REPORTS AND FORM 144S

On June 2, 2022, the SEC adopted amendments to its rules governing the electronic filing and submission of documents. The new rules require that certain documents which were once submitted in paper must now be submitted via an electronic submission on EDGAR, in accordance with the EDGAR Filer Manual.

The amendments became effective on July 11, 2022, and include, among others, the following compliance dates when electronic submission will be required:

- beginning January 11, 2023 for "glossy" annual reports to security holders (in PDF); and
- beginning April 13, 2023 for Form 144s related to proposed sales of securities of public companies.

Pursuant to Rule 14a-3(c) or Rule 14c-3(b) under the Exchange Act, companies are required to provide their security holders an annual report (frequently referred to as a "glossy" annual report because it often is printed on high gloss paper) before or at the time the company furnishes a proxy statement to security holders. Many companies that use such reports have been in the practice of posting them to their websites and will, now that these new rules are effective, also need to file them with the SEC. Companies will have the option to submit the "glossy" annual reports in Form ARS as a primary filing in PDF or in the Form ARS and, for foreign private issuers, Form 6-K as exhibit type EX-99 in PDF as an official filing format.

A Form 144 is filed with the SEC by an affiliate of a public company in order to effect a transaction in a "control" security (i.e., any security held by such affiliate, regardless of how the affiliate acquired the securities) that would otherwise require registration under the Securities Act. This requirement is triggered when a proposed sale of the company's stock to be sold during any three-month period exceeds (i) 5,000 shares or units or (ii) has an aggregate sale price of greater than $50,000. An affiliate is defined as a person in a relationship of control with the public company. Affiliate for these purposes generally include directors,

3 This may, however, not be the last word on the subject. While the "cooling off" period and other restrictions for issuers contemplated by the proposing release were not carried through to the final rule, the SEC stated in the adopting release that it is continuing to consider whether regulatory action is needed to mitigate any risk of investor harm from the misuse of Rule 10b5-1 plans by the issuer, such as in the share repurchase context. As discussed above under "Impact of Inflation Reduction Tax Excise Tax on Stock Buybacks," the SEC's proposal expanding share repurchase rules, which was released concurrently with the release of the 10b5-1 amendments proposal, is still pending.

executive officers and large shareholders of the company. Previously, paper or e-mail submissions of required Form 144s were primarily handled by the broker-dealer effecting the transaction, so company affiliates (and companies that help such affiliates with SEC filing-related matters) will need to consider what preparations are necessary for the new regime, which may include obtaining EDGAR filing codes for persons who have not needed them before.

According to the SEC, the amended rules will promote more efficient storage, retrieval and analysis of these documents as compared to a paper submission, and will modernize the manner in which information is submitted to the SEC. The amended rules also will improve the SEC's ability to track and process filings and modernize the SEC's records management process. Furthermore, publicly filed electronic submissions will be more readily accessible to the public and will be available on the SEC website generally in easily searchable formats, which benefits investors and other users of the documents.

4. INTERLOCKING DIRECTORATES

In recent months, the US Department of Justice (DOJ) Antitrust Division has emphasized its intent to crack down on unlawful interlocking directorates under Section 8 of the Clayton Act, noting that it "will not hesitate to bring Section 8 cases to break up" unlawful interlocks.[4] In connection with this enforcement push, the DOJ has indicated that it intends to utilize public companies' SEC filings to uncover potentially unlawful interlocks, rather than relying on information it receives in connection with premerger notifications under the Hart-Scott-Rodino Act. As a result, the SEC has also turned its attention to the effectiveness of companies' required disclosure controls and procedures in the context of director independence and interlocking directorates. Thus, it is important to understand the focus of this enforcement trend to ensure proper screening measures are in place to identify and remediate potential director interlock issues and related disclosure deficiencies.

Section 8 prohibits any person from serving "as a director or officer in any two corporations" that are competitors, with "competitors" meaning entities that could violate Section 1 of the Sherman Act if they agreed not to compete.[5] The prohibition on interlocking directorates does not apply where: (i) the interlock involves financial institutions, such as banks or trust companies; (ii) the director or officer vacates a position creating an interlock within up to one year from the "event causing ineligibility;" and (iii) where the competition between the entities is de minimis.[6]

Importantly, the DOJ has recently signaled that Section 8 is not necessarily restricted to incorporated entities, meaning that it could seek to bring enforcement actions related to interlocks between partnerships, limited liability companies or other types of entities. Additionally, the DOJ may broaden its definition of "competitive sales" going forward in determining whether entities are competitors and whether the de minimis exceptions are met. As part of its enforcement push, the DOJ in October 2022 scrutinized interlocks involving seven directors, resulting in the resignations of these directors from five companies.[7] In connection with this wave of resignations, the DOJ noted that this review was only the first in a broader review of potential interlocks.

Interlocking directorates can also create issues under the securities laws where a company's disclosure controls and procedures are insufficient to identify director independence issues required to be disclosed in SEC filings. Because public companies regularly report on director independence, committee independence and interlocking directorate relationships in annual proxy statements and periodic reports incorporated by reference therein, failure to identify and disclose related issues may run afoul of Sections 12, 13(a) and 14(a) of the Exchange Act, as well as Rules 13a-15(a), 13a-1, 13a-11, 12b-20, 14a-3 and 14a-9 and Item 407 of Regulation S-K.

Given this renewed emphasis on unlawful director interlocks between competitors and proper disclosures relating to

4 *See* Assistant Attorney General Jonathan Kanter's Opening Remarks at the 2022 Spring Enforcers Summit. The DOJ shares joint enforcement responsibility of the Clayton Act with the Federal Trade Commission.

5 *See* 15 U.S.C. § 19.

6 Competition will be deemed de minimis if it satisfies any of the following three tests: (1) the competitive sales of either corporation are less than $4,103,400, adjusted annually for inflation; (2) the competitive sales of either corporation are less than two percent of that corporation's total sales; and (3) the competitive sales of each corporation are less than four percent of that corporation's total sales.

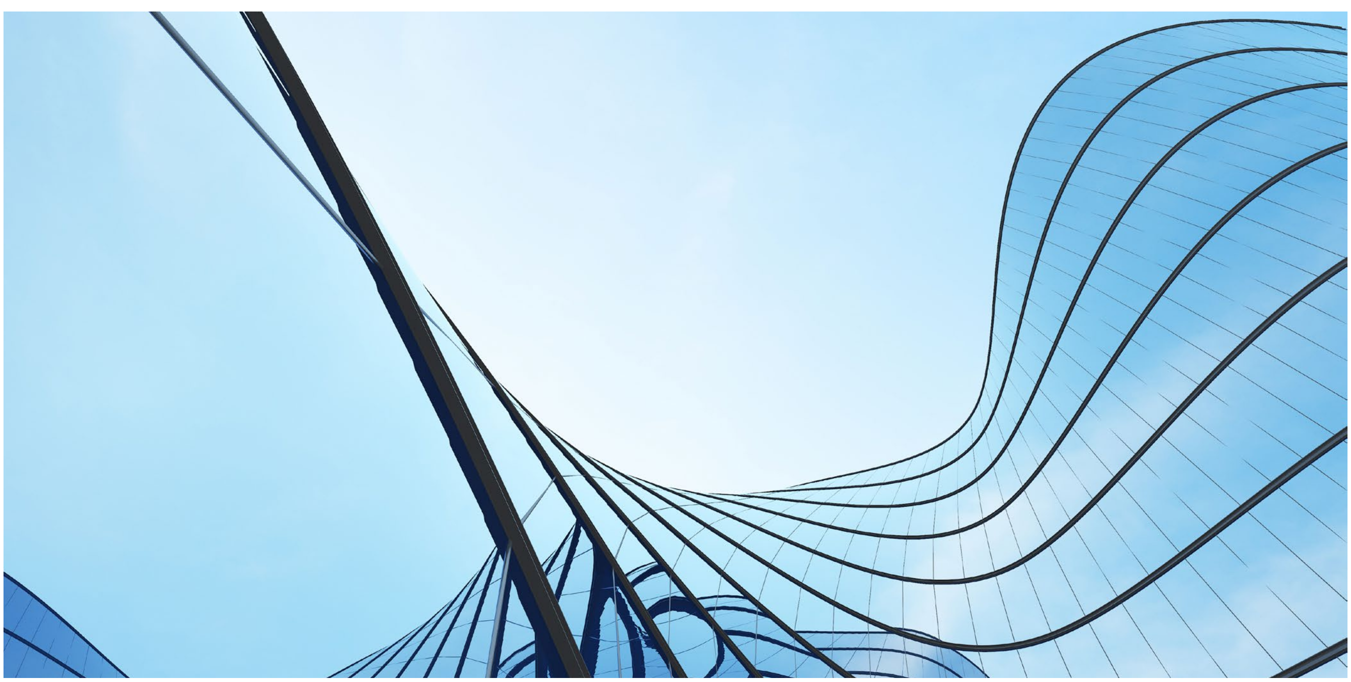
7 See the DOJ's announcement of the resignations.

director independence and interlocking relationships, companies should consider Section 8 concerns when structuring business arrangements, particularly where they involve entities that could potentially be identified as competitors. Companies should also periodically review their disclosure controls and procedures to ensure that independence is properly evaluated and disclosed in SEC filings. Maintaining effective controls and procedures can also help to proactively identify any potential interlocking relationships with competing companies, thereby helping to avoid Section 8 concerns.

5. OUTSTANDING REGISTRATION STATEMENTS AND FORM 10-K FILINGS

If a public company has any outstanding registration statements, filing of a new Annual Report on Form 10-K generally requires an update to such registration statements. Outstanding registration statements on Form S-1 will require the filing of a post-effective amendment in order to incorporate the new annual financial statements by reference. For Form S-3 and Form S-8, this incorporation by reference happens automatically, although a new consent related to such incorporation by reference of the new audit reports contained in the Form 10-K must be obtained and filed as an exhibit to the 10-K.

With respect to any outstanding registration statements on Form S-3, a company will also need to make sure it continues to meet the eligibility requirements for using the Form S-3 at the time it files its Form 10-K. In particular, if the company has previously filed a shelf registration statement which was automatically effective because the company had determined that it was a well-known seasoned issuer (WKSI), the company will need to confirm that it still meets the requirements of a WKSI for it to continue to use that registration statement. To be a WKSI, the main requirement is that the company have a public float held by non-affiliates of at least $700 million as of the applicable determination date, which includes the date the Form 10-K is filed for these purposes. If the public company does not meet the WKSI criteria, it would need to file a post-effective amendment to the S-3 registration statement to convert it to a non-WKSI shelf and follow procedures set forth in applicable SEC guidance in order to continue using the registration statement while doing so. If the company originally filed a non-WKSI shelf registration statement, the company would need to confirm that it still meets the applicable requirements to use Form S-3 set forth in the instructions thereto. If a public company fails to meet the requirements under Form S-3, it will need to re-file the non-WKSI registration statement as a Form S-1 and abide by the enhanced requirements of such form.



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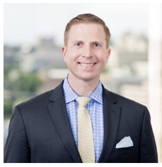
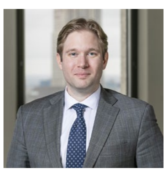


James V. Davidson
Partner, Houston
jdavidson@HuntonAK.com
+1 713 220 3649

Mayme Beth F. Donohue
Counsel, Richmond
mdonohue@HuntonAK.com
+1 804 787 8021

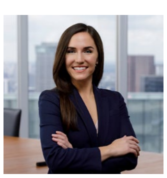
Greta Chwalek
Associate, Richmond
gchwalek@HuntonAK.com
+1 804 788 7209



Brendan P. Harney
Associate, New York
bharney@HuntonAK.com
+1 212 309 1255

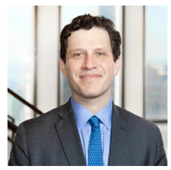
Adam Lyons
Senior Attorney, Houston
alyons@HuntonAK.com
+1 713 220 3746

Elizabeth P. White
Associate, Richmond
whitee@HuntonAK.com
+1 804 344 7836



Alexa N. Williams
Associate, Houston
williamsa@HuntonAK.com
+1 713 220 3659

Scott H. Kimpel
Partner, Washington, DC
skimpel@HuntonAK.com
+1 202 955 1524



Samuel M. Kardon
Counsel, New York
skardon@HuntonAK.com
+1 212 309 1189

Monika M. Dziewa
Associate, New York
mdziewa@HuntonAK.com
+1 212 309 1377

Patrick Jamieson
Associate, New York
pjamieson@HuntonAK.com
+1 212 309 1049

Kaitlyn Thorson
Associate, Houston
kthorson@HuntonAK.com
+1 713 220 4103

Thomas White
Associate, New York
twhite@HuntonAK.com
+1 212 309 1389

Jingyi “Alice” Yao
Associate, New York
ayao@HuntonAK.com
+1 212 309 1376

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ANDREWS KURTH

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