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"The Latest: Your Upcoming Proxy Disclosures"

Thursday, January 9, 2025

Course Materials

<u>"The Latest: Your Upcoming Proxy Disclosures"</u>

Thursday, January 9, 2025

2 to 3:30 p.m. Eastern [archive and transcript to follow]

Following up where our Fall conferences left off, this critical webcast will provide you with the latest guidance — including the latest SEC positions — on how to improve your executive and director pay disclosure to improve voting outcomes and protect your board, as well as how to handle the most difficult issues on oversight, engagement and disclosure of executive and director pay. Hear from these experts:

- **Mark Borges**, Principal, Compensia and Editor, CompensationStandards.com
- **Alan Dye**, Partner, Hogan Lovells LLP and Senior Editor, Section16.net
- **Dave Lynn**, Partner, Goodwin LLP and Senior Editor, TheCorporateCounsel.net and CompensationStandards.com
- **Ron Mueller**, Partner, Gibson, Dunn & Crutcher LLP

Among other topics, this program will cover:

1. Potential Impact of New Administration on SEC Rulemaking
2. Potential Impact on Compensation Disclosure
3. Evolution of Clawback Policies
4. Pay vs. Performance
5. Proxy Advisor Compensation Policy Updates
6. The Key CD&A Topics and Tabular Insights
7. New Item 402(x) and Equity Grant Policies
8. Incentive Plan and ESG Metric Trends
9. Compensation-Related Shareholder Proposals
10. Planning for 2025 Say-on-Pay Votes
11. Planning for 2025 Equity Plan Proposals

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Course Outline

1. Potential Impact of New Administration on SEC Rulemaking

    - Temporary freeze on pending rulemakings so that new appointees or designees have the opportunity to review any new or pending regulations
    - Policy positions of SEC Chair nominee Paul Atkins
    - Potential capital formation initiatives
    - Pending litigation regarding climate disclosure rule and proxy advisor regulation
    - Impact of the Department of Government Efficiency (DOGE) on SEC funding and operations
    - Future of SLB 14L

2. Potential Impact on Compensation Disclosure

    - CEO Pay Ratio — Item 402(u) of Regulation S-K
    - Rule 701 — Exempts certain sales of securities made by private companies to compensate employees, consultants and advisors

3. Evolution of Dodd-Frank Clawback Policies under Exchange Act Rule 10D-1, Nasdaq Rule 5608 and Section 303A.14 of the NYSE Listed Company Manual

    - Discussion of clawback disclosures under Item 402(w) of Regulation S-K to date
        - More clawback disclosures expected as calendar year companies disclose results for 2024
    - SEC Disclosure Review Program Staff comment letters on clawback disclosures

        - The Staff is taking a close look at what companies say about the application of their policies
        - Requesting that companies further explain the conclusion that there was no incentive-based compensation tied to financial performance during the relevant recovery period under Item 402(w)(2) of Regulation S-K
    - Clawback mechanics
        - Calculating the impact of the restatement
        - Sources of clawed-back compensation

4. Pay vs. Performance under Item 402(v) of Regulation S-K — Preparing for the First Year of Five-Year Disclosure
    - Most companies will add the most recently completed fiscal year and maintain disclosures for the prior four fiscal years in their pay versus performance disclosures included in 2025 proxy statements so that the disclosures cover their five most recently completed fiscal years
    - Comment letter trends:
        - Failing to provide net income (loss), as reported in the audited GAAP financial statements, in column (h) of the Pay Versus Performance Table
        - Failing to disclose how non-GAAP Company-Selected Measures are calculated from the audited financial statements
        - Insufficient relationship disclosures, especially when provided in narrative format
        - Double checking amounts reported in the Pay Versus Performance Table, including amounts reported as

Compensation Actually Paid, and descriptions of adjustments made to the Summary Compensation Table measure of total compensation to derive Compensation Actually Paid

- Clarifying comments — *e.g.*, (1) the Company-Selected Measure cannot span fiscal years (even if it doesn't exceed one fiscal year), and (2) when errors are identified in previously reported amounts of Compensation Actually Paid and companies adjust those prior year amounts in the current year proxy statement, Regulation S-K CDI 128D.03 may not be available to limit the reconciliation table in the Item 402(v)(3) footnote disclosures to the most recently completed fiscal year because including prior years' footnote disclosure may be material to an investor's understanding of the information reported in the table for the most recent fiscal year or of the relationship disclosure provided under Item 402(v)(5) of Regulation S-K

5. Proxy Advisor Compensation Policy Updates

- Glass Lewis made two updates related to executive compensation matters for the 2025 Voting Guidelines. Here is the description from the Summary of Changes for 2025:

  - Change-in-Control Provisions: "We have updated our discussion of change-in-control provisions in the section "The Link Between Compensation and Performance" to define our benchmark policy view that companies that allow for committee discretion over the treatment of unvested awards should commit to providing clear rationale for how such awards are treated in the event a change in control occurs.

  - Approach to Executive Pay Program: "We have provided some clarifying statements to the discussion in the section titled 'The Link Between Compensation and Performance' to emphasize Glass Lewis' holistic approach to analyzing executive compensation programs. There are few program features that, on their own, lead to an unfavorable

recommendation from Glass Lewis for a say-on-pay proposal. Our analysis reviews pay programs on a case-by-case basis. We do not utilize a pre-determined scorecard approach when considering individual features such as the allocation of the long-term incentive between performance-based awards and time-based awards. Unfavorable factors in a pay program are reviewed in the context of rationale, overall structure, overall disclosure quality, the program's ability to align executive pay with performance and the shareholder experience and the trajectory of the pay program resulting from changes introduced by the compensation committee."

- In their proposed changes to their Benchmark Policy Guidelines, ISS provided a summary of ongoing considerations related to U.S. executive compensation policy on the use of performance- versus time-based equity awards, including a planned change in policy application for 2025 (under the current policy). Here's more from the request for comments:

  "The current pay-for-performance assessment for executive compensation under ISS U.S. benchmark policy considers a predominance of time-vesting (as opposed to performance-vesting) equity awards to be a significant concern at a company that exhibits a quantitative pay-for-performance misalignment. However, a growing number of investors have expressed changing viewpoints regarding U.S. equity award practices. Some investors highlight concerns with performance equity programs that may be poorly designed and/or disclosed, including concerns about highly complex programs and non-rigorous performance measures, and some consider that well-designed time-vesting awards are preferable to performance-vesting awards.

  These changing viewpoints were demonstrated by the results of a question in the 2024 Global Benchmark Policy Survey … Considering the various feedback and arguments put forward, a potential policy update remains under consideration for 2026 (or later) regarding the

evaluation of the equity pay mix for regular-cycle equity awards whereby a preponderance of time-vesting equity awards generally would not in itself raise significant concerns in the qualitative review of pay programs.

For 2025 and in advance of any potential wider policy changes for 2026, we intend to implement certain pay-for-performance policy application changes…that do not require formal policy changes at this time but are adaptations within the current U.S. benchmark policy framework …

Effective for 2025 (for meetings on or after Feb. 1, 2025), we will introduce adaptations to the qualitative review of performance-vesting equity awards carried out under the current U.S. benchmark policy. Specifically, any design or disclosure concerns regarding performance equity will carry greater weight in the qualitative analysis, and significant concerns in these areas will be more likely to drive an adverse say-on-pay recommendation for a company that exhibits a quantitative pay-for-performance misalignment. Further details on the changes will be provided in an update to ISS' U.S. Executive Compensation Policies FAQ, expected to be published in mid-December 2024."

6. The Key CD&A Topics and Tabular Insights

    - Focus on shareholder engagement disclosures
    - Don't forget to give discussion time to non-CEO named executive officers, especially when there's a one-time award
    - Disclosing adjustments and earned amounts

7. New Item 402(x) and Equity Grant Policies

    - New Item 402(x) of Regulation S-K requires disclosure of policies and practices related to the grant of certain equity awards close in time to the release of material nonpublic information, including specific

tabular disclosure regarding the grant and stock price in the event that the company awarded options to an NEO in the period beginning four business days before the filing or furnishing of a 10-K, 10-Q or Form 8-K that discloses MNPI and ending one business day after the filing or furnishing of such report

8. Incentive Plan and ESG Metric Trends

   - Trends in the use of ESG metrics in compensation plans

   - Trends in long-term and short-term incentive plan design

9. Compensation-Related Shareholder Proposals

   - Common proposals in the 2024 proxy season:

     - Binding director Say-on-Pay

     - Shareholder approval of termination pay for executives exceeding 2.99x the sum of the executive's base salary plus target short-term bonus

     - Broaden the scope of existing management and executive clawback policies

     - Adopt policies requiring named executive officers and certain others to retain a percentage of stock acquired through equity programs until reaching retirement age

10. Planning for 2025 Say-on-Pay Votes under Exchange Act Section 14A and Rule 14a-21

   - In 2024, the average support for Say-on-Pay proposals was similar to historical norms but improved, and the failure rate was down

   - "Split" recommendations were more common in the 2024 proxy season — that is, ISS would recommend one way and Glass Lewis would recommend another way

- Trends in the impact of “against” recommendations from the proxy advisors

11. Planning for 2025 Equity Plan Proposals

    - Average shareholder support for equity plans improved in 2024
    - Per this blog, remember to first:
        - Assess your equity usage profile
        - Assess the market competitiveness of your equity granting practices
        - Determine what you really need to grant a competitive level of equity

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GIBSON DUNN

Public Policy Update

December 6, 2024

DOGE Details: The Knowns and Unknowns of Trump's Cost-Cutting Board

This update addresses some of the most common questions clients have about DOGE and discusses how DOGE might be structured, its proposed objectives and legal barriers to achieving those objectives, and its potential authorities and mechanisms for action.

President-elect Trump has tasked an entity he has dubbed the Department of Government Efficiency (DOGE) with making good on his campaign promises of cutting government spending and reducing regulatory burdens. How DOGE, led by Elon Musk and Vivek Ramaswamy, will accomplish these mandates has raised many questions for our clients. DOGE's structure, composition, authorities, sources of funding, objectives, and internal processes remain unknown, as does how DOGE's agenda will affect clients who must comply with potentially changing regulations. This Alert addresses some of the most common questions clients have about DOGE, including how DOGE might be structured, its proposed objectives and legal obstacles to achieving those objectives, and its potential authorities and mechanisms for action.

I. What is DOGE?

As of now, DOGE's structure remains unclear. President-elect Trump has stated that DOGE will operate "outside the government."[1] Based on its proposed function and precedent, it most likely will be a federal advisory committee (FAC) subject to the requirements of the Federal Advisory Committee Act (FACA). President Reagan's Private Sector Survey on Cost Control (known as the Grace Commission) and President Obama's National Commission on Fiscal Responsibility and Reform (known as the Simpson-Bowles Commission) are DOGE's nearest analogues, and

both operated as FACs. It is possible, however, that DOGE also may try to operate as an independent, non-governmental organization. DOGE's status will determine the restrictions and requirements that will apply to it and its members.

A. What is a Federal Advisory Committee?

If DOGE is a FAC, it will be subject to the various recordkeeping, disclosure, and conflicts requirements of FACA. The statute provides a formal process for establishing, operating, overseeing, and terminating bodies that advise the president or an executive branch agency. Under the statute, a FAC is any "committee, board, commission, council, conference, panel, task force, or other similar group" that (1) includes at least one non-governmental member; (2) is "established or utilized to obtain advice or recommendations for the President or one or more agencies or officers of the Federal Government"; and (3) "established or utilized by the President; or . . . established or utilized by one or more agencies."[2]

Whether DOGE is classified as a FAC will depend on its structure and operations. The president or an agency typically will establish FACs by an order that describes the function of the FAC, its composition, and its administration.[3] Even if a president or agency does not declare an entity to be a FAC, however, courts can rule that an entity is a FAC if it performs the functions of a FAC and enjoin its activities unless and until it complies with FACA.[4]

To courts, an "important factor" will be whether DOGE has "an organized structure, a fixed membership, and a specific purpose."[5] Additionally, to the extent DOGE "render[s] advice *as a group*, and not as a collection of individuals," courts may be more inclined to classify DOGE as a FAC.[6]

Even if DOGE were otherwise a FAC, the Trump administration or DOGE itself may conclude, as some scholars have, that FACA is unconstitutional in whole or in part because the president has "inherent power to seek the views of outside advisers" under the Vesting and Recommendation Clauses of the Constitution.[7] Then-Deputy Attorney General Antonin Scalia supported a version of this argument in 1974,[8] but courts have generally avoided addressing the argument to date.[9] Whether a court would agree with that position is unclear.

B. What would be the implications if DOGE is a FAC?

If DOGE is classified as a FAC, it presumably will have to comply with FACA's transparency and conflict of interest requirements. FACA requires presidential advisory committees (i.e., FACs that advise presidents) to file a charter outlining the committee's objectives and duties with the General Services Administrator, open most committee meetings to the public, and make their records available under the Freedom of Information Act.[10] Additionally, any directive establishing a FAC must include "appropriate provisions" to ensure the FAC's advice "will not be inappropriately influenced by the appointing authority or by any special interest."[11] Thus far, no definitive authority exists regarding what FAC procedures comply with FACA's inappropriate influence requirement. Further, the viewpoints of FAC members must be "fairly balanced."[12]

i. How could FACA requirements be enforced?

Although some courts have held that FACA does not create a cause of action, plaintiffs may be able to challenge DOGE's compliance with FACA and related laws in at least three other ways.[13] First, at least one court has assumed that FACs are subject to the Mandamus Act.[14] The Mandamus Act creates subject-matter jurisdiction over any action to "compel an officer or employee of the United States or any agency thereof to perform a duty owed to the plaintiff."[15] Second, although some courts have held that FACs are not agencies that can be sued under the Administrative Procedure Act (APA), they have allowed suits against the convening agency for a FAC's failure to comply with FACA.[16] Third, some courts have allowed suits to proceed directly against FACs under the Freedom of Information Act.[17]

ii. What authorities would DOGE have if it is a FAC?

As the term implies, federal advisory committees are meant to provide advice to the president and federal agencies. In FACA's findings, Congress specifically stated that the "function of advisory committees should be advisory only, and all matters under their consideration should be determined, in accordance with law, by the official, agency, or officer involved."[18] That said, the statute also provides that "advisory committees shall be utilized solely for advisory functions" "[u]nless otherwise specifically provided by statute or Presidential directive.[19]

Thus, if DOGE is a FAC, we anticipate that it will advise the president and agencies, and it is possible that Trump will try to authorize DOGE to carry out some of its recommendations—although we have seen no precedent for this, and Trump would have to overcome several legal obstacles to do so. For example, statutes often provide that only agency heads can modify regulations,[20] and any exercise of "significant authority" could raise constitutional questions about whether Musk and Ramaswamy are invalidly appointed officers of the United States.[21] Beyond legal challenges, having private persons implement controversial recommendations likely would create much public controversy. The Reagan administration considered empowering a successor to the Grace Commission with the authority to implement its recommendations but, based on a memorandum drafted by then-Associate Counsel to the President John Roberts, declined to do so amidst concerns that it would create public uproar and "serious conflict of interest problems" in having corporate executives implement recommendations with regard to agencies that regulated their businesses.[22]

Accordingly, it appears likely that DOGE will make recommendations and advise Trump, agency leaders, and agency staff on how to implement its recommendations.

iii. What would be the implications for DOGE's members if it is a FAC?

Musk, Ramaswamy, and other DOGE personnel may be subject to disclosure and conflict-of-interest rules if DOGE is a FAC. Private sector individuals participate on FACs in one of two capacities: either as a special government employee (SGE) or a representative member.[23] SGEs are typically (but not always) paid and exercise their own, independent judgment on behalf of the government. Representative members generally are not paid and represent the perspective of an identifiable outside organization or industry—they are expected to offer a biased view.[24] In this case, although Musk and Ramaswamy are not taking pay,[25] they are being presented as leaders of DOGE and offering their independent judgment about the

functioning of the entire government, making them appear to be closer to SGEs than representative members of a FAC. Some media sources have reported that Musk will be a special government employee, but there has not yet been a public announcement.[26]

If DOGE members serve as SGEs, they would have to file financial disclosures and would be subject to federal employee criminal conflict of interest rules if they use their "public office for their own private gain."[27] They would not be permitted to serve for longer than "one hundred and thirty days during any period of three hundred and sixty-five consecutive days."[28] Of note, they would be barred from participating "personally and substantially in an official capacity" in any matter in which they have a financial interest if the matter "will have a direct and predictable effect on that interest."[29] Such interests can include matters relevant to their companies as well as companies in which they own stock. That said, the official responsible for appointing the DOGE members (likely Trump) can waive the federal employee conflict-of-interest laws if he "certifies in writing that the need for the individual's services outweighs the potential for a conflict of interest created by the financial interest involved."[30]

The Federal Acquisition Regulation also imposes organizational conflict-of-interest restrictions on SGEs. Contracting officers are not permitted to knowingly award contracts to SGEs or their companies if the contract arises directly out of the individual's activity as an SGE, their activity puts them in a position to influence the award of the contract, or the contracting officer determines that another conflict exists.[31] The agency head may authorize an exception "only if there is a most compelling reason to do so, such as when the Government's needs cannot reasonably be otherwise met."[32] Competitors also may try to challenge the award of contracts based on perceived organizational conflicts of interest. Musk's companies Tesla and SpaceX, along with several companies of other individuals reported to be associated with DOGE, are government contractors that could be affected by their executives' DOGE service.

iv. How could DOGE be funded if it is a FAC?

If DOGE is classified as a FAC, it may be funded either by public or private sources. The General Services Administration provides public funds for FACs. Based on the precedent of President Reagan's Grace Commission, which received its funding from a private foundation established to support it, DOGE could also receive funding from private entities.[33]

C. What would be the implications if DOGE operates as an independent or informal non-governmental organization or think tank?

DOGE also could operate as a think tank or nonprofit that has a bully pulpit and the president's ear. As noted above, DOGE could attempt to avoid being classified as a FAC by taking on an informal structure and rendering advice as individuals rather than as a group. If DOGE successfully avoids being classified as a FAC and instead operates as an independent, non-governmental organization, it will not be subject to FACA's disclosure, transparency, or conflict-of-interest requirements or to FOIA. Musk has asserted that DOGE will pursue "maximum transparency" and that "[a]ll actions of [DOGE] will be posted online,"[34] but avoiding FACA's requirements would give DOGE and its members materially more flexibility on matters of transparency and conflicts of interests.

As an NGO, DOGE would have no legal authority to implement its recommendations, but could still publish reports and advise the President Trump directly. To the extent that DOGE's activity constituted lobbying, it would have to file disclosures under the Lobbying Disclosure Act, and it would be subject to additional lobbying limits if it is a tax-exempt entity.[35] Although communications made in the course of participating in a FAC are excluded from the definition of a "lobbying contact," there is no equivalent across-the-board exception for NGO activities.[36]

II. How will DOGE be staffed?

In addition to Musk and Ramaswamy, Trump has announced that William McGinley—who was Trump's White House Cabinet secretary in his first administration and initially had been Trump's designee for White House Counsel in the second administration—will be "Counsel to the Department of Government Efficiency."[37] In November, DOGE called for staff applications via a post on X, stating "we need super high-IQ small-government revolutionaries willing to work 80+ hours per week on unglamorous cost-cutting. If that's you, DM this account with your CV. Elon & Vivek will review the top 1% of applicants."[38]   It appears that applying via direct message is the only public process for interested applicants to submit their resumes to DOGE.[39]

In addition to staff, a number of corporate executives are reported to be advising DOGE. Those executives include: Bill Ackman (founder and CEO, Pershing Square Capital Management), Marc Andreesen (co-founder, Andreesen Horowitz), Steve Davis (President, Boring Company), Antonio Gracias (founder and CEO, Valor Equity Partners), Travis Kalanick (former Uber CEO; current CEO, City Storage Systems), Sriram Krishnan (General partner, Andreesen Horowitz), Joe Lonsdale (co-founder, Palantir), and David Sacks (general partner, Craft Ventures).[40]

III. What are DOGE's goals and likely targets?

DOGE's overarching goals are to reduce the deficit, reduce the federal workforce, and curtail the administrative state. DOGE has identified a number of specific objectives, many of which are subject to a variety of legal and political challenges.

A. Significantly reduce the deficit.

Musk and Ramaswamy have announced DOGE's intent to dramatically reduce federal spending and related waste, fraud, and abuse.[41] Musk has suggested a target of $2 trillion in cuts;[42] via X, DOGE has announced a goal of balancing the budget.[43]

i. What spending will DOGE target?

Musk, Ramaswamy, and the DOGE X account have identified a number of targets for spending reductions. These include several specific appropriations or federal grants that they consider to be wasteful, such as appropriations for NGOs, DEI training programs, PBS, NPR, $300 million in funding to Planned Parenthood and related organizations, and $1.5 billion in grants to international organizations.[44] Musk told lawmakers he supports "get[ting] rid of all [tax] credits" for electric vehicles—which he said "will only help Tesla,"[45]—and has previously advocated removing subsidies from all industries.[46] Ramaswamy has also asserted that DOGE will closely review CHIPS Act contracts, especially those the Biden administration accelerated ahead

of the transition.[47] The DOGE X account has also identified Pentagon spending as a potential area for reduction, although President Trump has said he would not cut defense spending.[48]

More generally, Musk and Ramaswamy have suggested that Trump may decline to spend appropriations for which Congress's authorizations have expired. The Congressional Budget Office has identified $516 billion in appropriations for 2024 associated with 491 expired authorizations of appropriations across a range of agencies, including a number of appropriations administered by the Department of Veterans Affairs, State Department, Department of Education, National Institutes of Health, Federal Aviation Administration, NASA, and more.[49] Note that Congress can appropriate funds without authorization or pursuant to an expired authorization; these appropriations carry their own authorizations and are available to agencies for "obligation and expenditure."[50] Withholding such funds likely would be subject to legal challenge. It likely also would be politically unpopular to cut a number of these programs, such as veterans' healthcare benefits and Pell Grants.

Other sources of potential cuts or reforms could be the Government Accountability Office High Risk List, which identifies programs particularly subject to waste, fraud, and abuse,[51] and a 2,000-page list of proposed cuts Senator Rand Paul (R-KY) has reportedly sent to Musk and Ramaswamy.[52]

Finally, DOGE will be open to suggestions from the public. Ramaswamy has announced that "DOGE will soon begin crowdsourcing examples of government waste, fraud, ... and abuse."[53] In addition, some Republican fundraising emails have announced that DOGE will be crowdsourcing its agenda with which government programs to cut and have included short surveys regarding the cuts.[54]

ii. Government contractors under the microscope.

Musk and Ramaswamy have also indicated a desire to scrutinize federal contracts that they state have "gone unexamined for years," and have alluded to conducting "[l]arge-scale audits . . . during a temporary suspension of payments."[55] Ramaswamy has said to expect "massive cuts among federal contractors . . . who are overbilling the government."[56] It is not clear how DOGE will decide which contracts to scrutinize, how it will go about reviewing those contracts, or how it will determine whether to recommend any for termination or modification. It is also not clear whether DOGE will recommend that agencies attempt to modify or terminate existing contracts still in effect, or if it will focus more on making changes when contracts are up for renewal. Nor is it clear how DOGE or the federal government would institute a "temporary suspension of payments," including whether it would attempt to require contractors' continued performance under those contracts during any such suspension. It is possible that DOGE will try to pressure contractors to agree to changes to the terms of contracts it deems wasteful.

iii. What challenges will DOGE face?

DOGE will face at least three obstacles in meeting its goal to significantly reduce the deficit.

First, during the campaign, Trump asserted he will not cut defense, Social Security, or Medicare,[57] but those and interest payments on the national debt constitute over 60 percent of

federal spending. All discretionary non-defense spending is less than $1 trillion, but the 2024 deficit is $1.8 trillion.[58] While Musk and Ramaswamy have generally steered away from discussing entitlement reform, they have suggested that at least some defense cuts could be on the table, including changes to the defense procurement process and eliminating waste generally, as well as, particularly from Musk, even the future of manned fighter jets like the F-35.[59]

Second, federal spending is authorized and appropriated by Congress, not the president (or his advisors). Congress may not be willing to authorize such drastic cuts to federal spending, especially if such cuts touch Social Security, Medicaid, and other programs that would be politically unpopular to curtail.

Third, statutes restrict the president's power not to spend money that has been appropriated. The Supreme Court overturned President Nixon's impoundments of congressionally-appropriated funds on the basis that, at least where the appropriations provide that "[s]ums authorized . . . *shall* be allotted," the appropriation itself does not implicitly provide the president discretion not to spend the full amount of those funds.[60] Congress then went further and passed the Impoundment Control Act which requires the president to propose rescissions to Congress if the president does not wish to spend appropriated funds. If Congress does not pass a rescission bill within 45 days, the funds must be made available for obligation.[61]

Precedent from the previous Trump administration may shed light on the challenges the new Trump administration may face under the Impoundment Control Act. In January 2020, the Government Accountability Office concluded that the Office of Management and Budget (OMB) violated the Impoundment Control Act when it withheld obligated funds for Ukraine security assistance.[62] OMB asserted the withholding was part of a "programmatic delay" pending policy developments and so did not require notice to Congress.[63] Similar disputes may arise if the second Trump administration attempts impoundment or similar withholdings without congressional approval. Notably, Trump has repeatedly asserted the ICA is unconstitutional and that the president is empowered to impound funds that have been appropriated by Congress. As part of his campaign, the Trump suggested that he would challenge the constitutionality of the ICA and simultaneously work with Congress to overturn the law.[64]

B. Streamline the federal workforce.

Musk and Ramaswamy have said they plan to eliminate a significant amount of the federal workforce and prescribe new rules for the civil service.[65] Musk and Ramaswamy seek to elicit voluntary resignations by ending remote work for federal government employees, relocating agencies out of D.C., providing early retirement incentives, and offering severance packages.[66] They also may seek to institute large-scale layoffs.[67] Federal civil service protections could impede some strategies to streamline the federal workforce, but those protections generally do not apply to large-scale mass layoffs.[68] Musk and Ramaswamy have also suggested that the president may modify civil service rules by executive order.[69]

Separately, Trump may be aiming to convert many civil service positions into political appointments, which would then give political leaders more control over appointment and

retention decisions. Trump has announced that he intends to nominate Russell Vought to head OMB. Late in Trump's first term, Vought designed a "Schedule F" classification to facilitate the conversion of civil service positions to political positions,[70] but President Biden cancelled that plan,[71] and the Office of Personnel Management promulgated formal rules through notice-and-comment rulemaking restricting such conversions of civil service positions into political positions.[72] Vought's nomination suggests the second Trump administration may attempt to resurrect Schedule F.

C. Curtail the administrative state.

Musk and Ramaswamy have said they plan to eliminate approximately 75 percent of federal agencies, in part by consolidating duplicative and miscellaneous agencies into larger agencies.[73] Musk and Ramaswamy also seek to halt enforcement of and eventually repeal regulations based on the logic of the Supreme Court opinions of *West Virginia v. EPA*,[74]—which approved the major questions doctrine that Congress does not implicitly authorize agencies to decide questions of vast economic and political significance—and *Loper Bright Enterprises v. Raimondo*[75]—which overturned *Chevron* deference to agency interpretations of ambiguous statutes. Musk and Ramaswamy interpret these cases to suggest that "a plethora of current federal regulations exceed the authority Congress has granted under the law."[76]

To achieve these goals, DOGE may have to overcome a number of legal obstacles. For example, agencies generally must go through notice-and-comment rulemaking to amend or revoke rules.[77] Musk and Ramaswamy have suggested that Trump may be able to revoke some rules unilaterally through executive order,[78] but it remains to be seen whether an agency acting on such orders would be acting arbitrarily and capriciously or otherwise in violation of the APA. More information regarding how Trump can pause agency rules that have not yet been finalized can be found in this Gibson Dunn Client Alert.

In addition, Musk and Ramaswamy also have suggested that Trump could direct agencies not to enforce regulations that the administration disfavors or believes are unlawful in light of recent Supreme Court precedent.[79]

i. Potential DOGE targets.

Musk and Ramaswamy have singled out many agencies as targets for consolidation and/or elimination. The Consumer Financial Protection Bureau (CFPB) is one such target: on November 27, 2024, Musk posted on X, "Delete CFPB. There are too many duplicative regulatory agencies."[80] The Department of Education is another target: in response to a question regarding the Department of Education, Ramaswamy stated that he expects "certain agencies to be deleted outright."[81] Musk is also expected to target agencies like the Federal Trade Commission, Securities and Exchange Commission, and Department of Justice for reductions.[82]

Additionally, agencies that appear on the GAO's High Risk List, which identifies agencies and programs that have significant potential for waste, fraud, or abuse, may be targets for consolidation or elimination.[83] The president's authority to delegate and reorganize such

agencies and programs, however, is constrained by statute.[84] Accordingly, significant agency reorganizations likely will require legislative action.[85]

D. Other objectives.

Lastly, DOGE plans to increase the use of AI and software within government more broadly and to reform the tax payment process by developing a free tax filing app.[86]

IV. Who in Congress intends to work with DOGE?

DOGE will have to partner with Congress and federal agencies to effect many of its plans, although Trump likely will be able to implement some of its recommendations via executive action. Even without direct implementation authority, however, DOGE's recommendations are likely to get sympathetic hearings from Trump's political appointees in the agencies.

Numerous Republican members of Congress, and some Democratic members, have expressed enthusiasm for some or all of DOGE's objectives and are forming entities within both the House and the Senate to partner with DOGE. The House Committee on Oversight and Reform has announced that it is forming a Delivering on Government Efficiency ("DOGE") subcommittee, chaired by Rep. Marjorie Taylor Greene (R-GA).[87] This subcommittee will, among other things, examine the "salaries and status of members of the federal civil service and intergovernmental personnel."[88]

Rep. Aaron Bean (R-FL) has launched a new congressional caucus aimed at working with DOGE, which he will co-chair with Rep. Pete Sessions (R-FL).[89] Democratic Congressman Rep. Jared Moskowitz (D-FL) has joined the caucus and it is reported other Democrats also may join.[90]

The Senate DOGE caucus is led by Senator Joni Ernst (R-IA.), and it will lead the Senate's partnership with DOGE.[91] Other caucus members include Senators John Cornyn (R-TX), Ted Budd (R-NC), Mike Lee (R-UT), Rick Scott (R-FL), Roger Marshall (R-KS), and James Lankford (R-OK). Sen. Ernst has already met with Ramaswamy to share suggestions for spending cuts, including consolidating government office space and reducing payments to the United Nations,[92] as well as reducing government telework.[93] Senator Bernie Sanders (I-VT) has said he will not join the caucus but that he intends to work with DOGE to go after waste specifically within the Department of Defense.[94]

V. How will DOGE engage with the public?

DOGE currently is engaging with the public via posts on its X account and posts on Elon Musk's X account. Musk has also suggested that DOGE will be open to suggestions and feedback, saying that "[a]nytime the public thinks we are cutting something important or not cutting something wasteful, just let us know!"[95] The House DOGE caucus has launched a tipline to receive public input, but it is unclear whether and how that will be communicated to DOGE itself.[96] Additionally, Ramaswamy has announced that he and Musk will host a podcast ("DOGEcast") that will provide the public with updates on DOGE.[97]

VI. How can businesses prepare for DOGE?

DOGE promises to be disruptive, but businesses can prepare to make the most of the situation by gathering information, advocating for their interests, and—if necessary—by being prepared to litigate. Specifically, businesses should consider whether and how best to:

- Identify regulations, programs, and contracts that (a) affect its business or its competitors and (b) may be targets for DOGE. This can include monitoring Musk, Ramaswamy, and DOGE's public statements and, if necessary, making FOIA requests.
- Advocate for their interests directly to DOGE. For example, consider proactive engagement on a particular contract that appears to be a focus of DOGE. In addition to more traditional forms of advocacy, it appears that DOGE may be unusually open to online and public advocacy.
- Develop relationships with members of Congress and administration officials who work with and can influence DOGE. DOGE is likely to work closely with allies on the Hill and in executive branch agencies and it could be prudent to communicate with those allies in addition to DOGE.
- Consider leveraging DOGE's work by challenging burdensome regulations in court, especially where the major questions doctrine or *Loper Bright* could apply. In light of recent Supreme Court decisions, even longstanding regulations might be susceptible to such a challenge.[98] In addition to potentially winning vacatur of the regulation, litigation might have the added benefit of bringing strong arguments against the regulation to DOGE's and the agency's attention.

VII. Conclusion.

The coming days will yield some answers to the questions posed here about DOGE. Gibson Dunn will be monitoring those developments closely, and our attorneys are available to assist clients as they navigate these challenges and opportunities that DOGE's recommendations may present.

The endnotes referenced in this update are available on Gibson Dunn's website. Please click on a particular footnote above to view details or view the full alert at the link below.

Read More

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Gibson Dunn's lawyers are available to assist in addressing any questions you may have regarding these developments. Please contact the Gibson Dunn lawyer with whom you usually

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Hogan Lovells

SEC Update

December 22, 2022

This is a commercial communication from Hogan Lovells. See note below.

SEC adopts major Rule 10b5-1 amendments and disclosure requirements relating to securities transactions

On December 14, the SEC adopted long-awaited amendments to Rule 10b5-1 under the Exchange Act that add new conditions for a trading arrangement to qualify for the rule's affirmative defense against Rule 10b-5 liability for insider trading.

As part of its larger project to curb unlawful insider trading, the SEC also adopted new requirements under which issuers will be required to disclose information about directors' and officers' trading arrangements, issuers' insider trading policies and procedures, and option grants made close in time to the issuer's disclosure of material nonpublic information. In addition, the SEC amended Forms 4 and 5 filed under Exchange Act Section 16 to require reporting persons to identify transactions intended to comply with Rule 10b5-1, and amended Exchange Act Rule 16a-3 to accelerate the deadline for reporting dispositions of securities by gift.

The SEC's adopting release (No. 33-11138) describing the rule amendments can be viewed here.

The amended rules will be effective 60 days after publication of the release in the Federal Register. Transition arrangements defer compliance by issuers with the new disclosure requirements and compliance by Section 16 reporting persons with the beneficial ownership report amendments.

Rule amendments at a glance

Amended conditions of Rule 10b5-1(c)(1) affirmative defense

The SEC has amended Rule 10b5-1(c)(1)'s affirmative defense conditions to close "loopholes" under the rule that it believes have been used by some directors, officers, and issuers to trade on the basis of material nonpublic information.

Under the amended rule, a new or modified Rule 10b5-1 trading arrangement entered into by a director, an officer, or any other person except the issuer will be subject to a minimum waiting or "cooling-off" period before the first purchase or sale of securities may be executed under the arrangement. Other amendments applicable to persons other than issuers provide that, with limited exceptions, the rule's affirmative defense is not available for open-market purchases or sales under multiple overlapping plans or under more than one single-trade plan during any 12-month period.

Directors and officers entering into a Rule 10b5-1 written plan will now be required to certify by a representation in the plan documents that they are doing so in good faith and that they are not aware of material nonpublic information about the underlying security or the issuer. The amendments expand the existing requirement that a Rule 10b5-1 trading arrangement must be "given or entered into" in good faith to add the condition that the trader must act in good faith during the term of the trading arrangement.

Among noteworthy differences from the rule proposal, the SEC did not require a cooling-off period for issuer Rule 10b5-1 plans or subject issuer plans to the new limitations on multiple overlapping plans and single-trade plans.

New disclosure requirements

Amendments to Regulation S-K and Exchange Act forms impose new disclosure requirements that are intended to expose to market scrutiny information about director and officer trading arrangements and governance practices related to insider trading. The new disclosures must be tagged in Inline XBRL.

Registrants are required to provide quarterly disclosure regarding the adoption, termination, and material terms of Rule 10b5-1 and non-Rule 10b5-1 trading arrangements entered into by their directors and officers. In their annual reports, registrants are obligated to disclose whether they have adopted insider trading policies and procedures (or, if they have not done so, to explain why not) and to file the policies and procedures as an exhibit to the report.

The amendments also require registrants to include in their annual proxy statements a discussion of their policies and practices regarding the timing of awards of options and similar equity instruments in relation to the disclosure of material nonpublic information. Registrants must present tabular disclosure of any such awards made in the last fiscal year to named executive officers during any period beginning four business days before and ending one business day after an earnings announcement or disclosure of other material nonpublic information.

Section 16(a) reporting amendments

To provide investors with transaction-specific disclosures regarding sales and purchases under Rule 10b5-1 plans, the amendments require Section 16 reporting persons to indicate by checkboxes in Form 4 and Form 5 if any reported transactions occurred pursuant to trading arrangements intended to satisfy Rule 10b5-1(c)(1)'s affirmative defense conditions.

The SEC has amended Exchange Act Rule 16a-3 to deter what it sees as problematic gift transactions by accelerating reporting of dispositions of securities by gift from a filing on Form 5 due after year-end to a filing on Form 4 due within two business days after the gift is made.

Transition arrangements

Although the amended rules will be effective 60 days after publication of the adopting release in the Federal Register, compliance with most of the new rules and requirements is subject to phase-in over a longer period.

Rule 10b5-1 plans

The amended conditions to the availability of Rule 10b5-1(c)(1)'s affirmative defense will apply to any new Rule 10b5-1 trading arrangements adopted after the effective date of the amendments.

The amendments will not affect the affirmative defense available under a Rule 10b5-1 trading arrangement entered into before the effective date, unless the existing trading arrangement is modified after the effective date in a manner that would constitute the "adoption" of a new trading arrangement. Upon such a modification – consisting of a modification or change in the amount, price, or timing of the purchase or sale of the securities underlying the trading arrangement – the trader would be subject to Rule 10b5-1(c)(1)'s amended conditions.

New disclosure and information tagging requirements

Issuers will be required to comply with the new disclosure and information tagging requirements "in the first filing that covers the first full fiscal period that begins on or after April 1, 2023" (or October 1, 2023, for smaller reporting companies).

Amended Section 16(a) reports

Section 16 reporting persons will be required to comply with the amendments to Forms 4 and 5 for beneficial ownership reports "filed on or after April 1, 2023."

Registrants and other persons subject to rule amendments

The amendments applicable to registrants extend to all categories of domestic companies subject to Exchange Act reporting requirements. Foreign private issuers that file annual reports on Form 20-F are also obligated to comply with the amended rules, except for the quarterly disclosure requirements, since those issuers do not file quarterly reports.

Persons other than issuers entering into Rule 10b5-1 trading arrangements must comply with Rule 10b5-1(c)(1)'s amended conditions, except for the new certification requirement, which applies only to the issuer's directors and officers, and except that directors and officers must comply with a longer mandatory cooling-off period than other persons.

For purposes of the new requirements, "officer" is defined in accordance with Rule 16a-1(f) under the Exchange Act, which is substantially similar to the standard for designating "executive officers" under Exchange Act Rule 3b-7.

Description of rule amendments

Amended conditions of Rule 10b5-1(c)(1) affirmative defense

Rule 10b5-1(c)(1) establishes an affirmative defense to liability under Rule 10b-5 if the purchase or sale of securities is made pursuant to (a) a binding contract, (b) an instruction to another person to execute the trade for the instructing person's account, or (c) a written plan. The SEC refers in its release to such a contract, instruction, or written plan as a "trading arrangement" or a "plan."

When it adopted Rule 10b5-1 in 2000, the SEC said it believed the affirmative defense would "provide appropriate flexibility to those who would like to plan securities transactions in advance, at a time when they are not aware of material nonpublic information, and then carry out these pre-planned transactions at a later time, even if they later become aware of material nonpublic information." The SEC has amended the conditions to the availability of the affirmative defense under Rule 10b5-1(c)(1) to address concerns that some issuers and corporate insiders have abused the rule to "opportunistically trade securities on the basis of material nonpublic information in ways that harm investors and undermine the integrity of the securities markets."

Mandatory cooling-off period. Rule 10b5-1(c)(1) did not formerly impose a minimum waiting period after adoption of a Rule 10b5-1 trading arrangement before the first purchase or sale of securities could be executed, although many arrangements have incorporated such "cooling-off" periods of varying durations. To address what it characterizes as "potentially abusive activity" when trades occur soon after adoption of a plan, the SEC has amended the rule to require a separation in time between the adoption date and the first trade.

As a condition to the availability of the affirmative defense, the amended rule requires (a) a minimum 90-day cooling-off period before the first transaction under Rule 10b5-1 director and officer trading arrangements and (b) a minimum 30-day cooling-off period before the first transaction under Rule 10b5-1 trading arrangements for all other persons except issuers. The SEC expects that any material nonpublic information of which such a trader might be aware when entering into a plan – contrary to a key condition of Rule 10b5-1(c)(1) – likely will become stale during the cooling-off period and thereby preclude the trader from profiting from the informational advantage when the first transaction occurs.

The cooling-off period applicable to director and officer trading arrangements could exceed 90 days under the formula specified in the rule, which defines the period as extending to the *later* of:

- 90 days after the adoption of the trading arrangement; and
- two business days following disclosure of the issuer's financial results in a Form 10-Q or Form 10-K for the completed fiscal quarter in which the trading arrangement was adopted (or, for foreign private issuers, in a Form 20-F or Form 6-K that discloses the issuer's financial results).

The *maximum* required cooling-off period is 120 days after plan adoption.

The SEC explains that it adopted this formula to deter corporate insiders from seeking to benefit from their knowledge of unreleased financial results for the quarter in which they entered into a Rule 10b5-1 trading arrangement. Further, by requiring a minimum cooling-off period of 90 days regardless of the earnings release date, the SEC is seeking to prevent improper trading by insiders aware of material nonpublic information – such as information about a major pending corporate transaction – that may be unrelated to the quarter's earnings.

The cooling-off period will begin after the "adoption" of the trading arrangement, which will include specified plan modifications. For purposes of the rule, any "modification or change in the amount, price, or timing of the purchase or sale of the securities" underlying a trading arrangement will constitute both a "termination" of the prior arrangement and the "adoption" of a new trading arrangement. A modification that merely substitutes or removes the plan broker administering the arrangement would not constitute a termination and adoption unless the modification also changes the price at which, or the date on which, purchases or sales of the securities will be executed.

The SEC adopted the shorter mandatory cooling-off period for persons other than directors and officers because such persons are less likely than directors and officers to be involved in making or overseeing corporate decisions about whether and when to disclose information, and are less likely to be aware of material nonpublic information.

The SEC did not adopt the proposed cooling-off period condition for issuer trading arrangements. The absence of such a condition will preserve the flexibility

of issuers to use multiple sequential trading plans for share repurchases to span trading blackout periods.

Limitation on multiple overlapping plans. The SEC has eliminated Rule 10b5-1(c)(1)'s affirmative defense for any director or officer who establishes multiple overlapping trading arrangements for open-market purchases or sales of securities, with the limited exceptions described below. The SEC did not adopt the proposed amendment that would have extended the limitation to issuer plans.

The amended rule's affirmative defense is not available for trades under a Rule 10b5-1 plan when the trader has another plan, or subsequently enters into an additional plan, for open-market purchases or sales of the issuer's securities – whether of the same or a different class – during the same period. The SEC indicates that the limitation is intended to preclude the use by corporate insiders of multiple overlapping plans to selectively cancel individual trades or terminate plans on the basis of material nonpublic information before the information is publicly released.

The overlapping-plans limitation does not apply to Rule 10b5-1 plan transactions in which directors, officers, or employees acquire or sell securities for themselves directly from the issuer, such as through their participation in an employee benefit plan, employee stock ownership plan, or dividend reinvestment plan, since such transactions are not executed by these participants in the open market.

In response to comments on the rule proposal, the SEC modified the limitation to permit traders to maintain additional Rule 10b5-1 plans in the following circumstances:

- *Plan authorizing only "sell-to-cover" transactions*: A director or officer may maintain another qualified Rule 10b5-1 plan that authorizes only qualified "sell-to-cover" transactions in which the agent is instructed to sell securities only in an amount necessary to satisfy tax withholding obligations at the time of vesting of an equity award – such as awards of restricted stock or stock appreciation rights, but not of options – so long as the insider does not otherwise exercise control over the timing of those sales.

  The amendment does not authorize sales under a second plan incident to the exercise of option awards because the exercise of such awards at the insider's discretion creates a risk of opportunistic trading. The SEC confirms that sell-to-cover transactions incident to option exercises may be executed under a single plan that authorizes other types of planned trades.

- *Later-commencing plan*: A trader may maintain two separate Rule 10b5-1 plans at the same time so long as trading under the later-commencing plan is not authorized to begin until after all trades under the earlier-commencing plan are completed or expire without execution. The SEC adopted this exception to preserve a person's ability to set up two successive Rule 10b5-1 plans for open-market trading in a way that would foreclose strategically timed trades based on material nonpublic information. The SEC has qualified the operation of this exception in a manner intended to ensure that both plans meet the cooling-off period condition, as well as the other conditions, of the affirmative defense.

- *Separate contracts involving multiple broker-dealers or other agents*: This exception is intended to permit use of multiple financial intermediaries when the plan securities are held in separate accounts with different financial institutions. The amended rule will treat as a single Rule 10b5-1 "plan" a series of separate contracts with different broker-dealers or other agents acting on behalf of a single person to execute trades under the contracts, each of which constitutes a Rule 10b5-1 plan.

  All of the contracts, taken together as a whole, must meet all of the conditions of, and remain collectively subject to, Rule 10b5-1(c)(1), including a requirement that a modification of any individual contract will act as a modification of the whole trading arrangement. A modification will not occur upon the substitution of a broker-dealer or other agent for the prior financial intermediary so long as the purchase and sales instructions are identical. The trader will thus be permitted to close a securities account with a financial institution and transfer the securities to a different financial institution without forfeiting the affirmative defense.

Limitation on single-trade plans. The SEC cites studies concluding that transactions under Rule 10b5-1 trading arrangements that cover a single trade are consistently "loss avoiding" for the traders and often precede declines in the issuer's stock price, which suggests to the SEC that the traders are executing "one-off," ad hoc trades based on material nonpublic information.

To deter this conduct, for all persons other than the issuer (which is not subject to this condition), the SEC

has limited Rule 10b5-1(c)(1)'s affirmative defense for open-market transactions under a single-trade plan to one such plan during any 12-month period. The affirmative defense would be available for a single-trade plan only if, during the prior 12-month period, the trader did not adopt another plan, which would otherwise qualify for the defense, that was "designed to effect the open-market purchase or sale of all of the securities covered by" the prior plan "in a single transaction."

The SEC explains that a plan is "designed to effect" the purchase or sale of securities in a single transaction when the plan "has the practical effect of requiring such a result." As examples of plans that would *not* have the effect of requiring a single transaction, the SEC refers to

- a plan that affords discretion to the person's agent over whether to execute the plan as a single transaction, and
- a plan that does not afford the agent such discretion, but instead provides that the agent's future acts will depend on events or data not known at the time the plan was entered into (such as when the plan instructs the agent to execute a certain volume of transactions at each of several specified future stock prices), where it is reasonably foreseeable at the time the plan was entered into that it "might" result in multiple transactions.

The amendment excepts from the single-trade limitation trades under a plan that authorizes only "sell-to-cover" transactions meeting the requirements described above, which will afford directors and officers the flexibility to meet tax withholding obligations related to the vesting of equity compensation.

Expansion of good faith condition. The Rule 10b5-1(c)(1) affirmative defense is available only if a Rule 10b5-1 trading arrangement was "entered into in good faith and not as part of a plan or scheme to evade" the rule's prohibitions. The SEC has added to the condition a requirement that the person entering into the trading arrangement "has acted in good faith" with respect to the trading arrangement, which will cover the trader's conduct during the term of the arrangement.

The SEC seeks with this amendment "to better ensure that material nonpublic information does not factor into the decision to trade" under Rule 10b5-1 plans. In the SEC's view, even if a corporate insider entered into a Rule 10b5-1 plan in good faith, the insider would not be acting in good faith with respect to the plan – and therefore would not be entitled to the rule's affirmative defense – if the insider

- materially modifies a planned trade at the insider's own direction and to the insider's own benefit based on material nonpublic information acquired after the plan was entered into, or
- while aware of material nonpublic information, directly or indirectly induces the issuer to publicly disclose the information in a manner that makes the insider's trades under the plan more profitable or less unprofitable.

In response to comments on the scope of the "good faith" requirement as it will apply to corporate insiders, the SEC clarifies that the obligation to act in good faith relates to "activities within the control of the insider." For example, according to the SEC, the issuer's cancellation of trades by an insider under a Rule 10b5-1 plan due to a possible merger or other corporate event "where such cancellations are outside the control or influence of the insider may not, by themselves, implicate the good faith condition."

Director and officer certifications. The amended rule requires a director or officer to certify on the date of the adoption of a new Rule 10b5-1 written plan that the director or officer

- is "not aware of any material nonpublic information about the security or issuer," and
- is adopting the written plan "in good faith and not as part of a plan or scheme to evade the prohibitions of" Rule 10b-5.

The director or officer also would have to provide the certification if the written plan were modified in a manner that would constitute the adoption of a new written plan, as described above. The SEC confirms that the certification would not be required if the director or officer terminates an existing Rule 10b5-1 plan and does not enter into a new or modified written plan for which the affirmative defense is sought.

Under the rule proposal, directors and officers would have been required to make the certification in a separate document presented to the issuer. In response to comments, the SEC has provided instead that the certification must be made in the form of a representation in the written plan documents.

The SEC has adopted the certification requirement to "reinforce" the "cognizance" of the certifying directors and officers of Rule 10b5-1(c)(1)'s good faith requirement and of their obligation not to adopt a trading arrangement while aware of material

nonpublic information. The SEC emphasizes that although a director or officer may consult legal counsel on the meaning of the terms "material" and "nonpublic information," the completion of the related certification would require a "fact-specific analysis" and should represent the trader's "personal determination" that the trader is not aware of material nonpublic information.

The SEC expresses the view that the certification does not constitute an independent basis of director or officer liability for insider trading under Exchange Act Section 10(b) and Rule 10b-5.

New disclosure requirements

The SEC's rulemaking has been directed at curbing unlawful insider trading conducted outside of, as well as under, Rule 10b5-1 trading arrangements.

In addition to adding new conditions to Rule 10b5-1(c)(1), the amendments aim to curb insider trading by requiring registrants to provide investors with an array of new disclosures about trading arrangements, insider trading compliance policies, and securities transactions. The SEC expects that the disclosures will enable investors to assess whether corporate insiders may have incentives to engage, or may be engaging, in securities transactions on the basis of material nonpublic information, and thereby will help to deter fraudulent conduct in violation of Exchange Act Section 10(b) and Rule 10b-5.

Quarterly reporting of Rule 10b5-1 and non-Rule 10b5-1 trading arrangements. The disclosure requirements are contained in a new Item 408 of Regulation S-K. Registrants are required to tag Item 408 information in Inline XBRL.

Item 408(a) and related form amendments require registrants to disclose, in each quarterly report on Form 10-Q and, for the fourth fiscal quarter, each annual report on Form 10-K:

- whether, during the registrant's last fiscal quarter, any director or officer adopted or terminated (a) any Rule 10b5-1 trading arrangement or (b) any other written pre-planned trading arrangement for the purchase or sale of the registrant's securities meeting specified criteria (referred to as a non-Rule 10b5-1 trading arrangement), in each case identifying the nature of the trading arrangement; and
- the material terms of the Rule 10b5-1 trading arrangement or non-Rule 10b5-1 trading arrangement – other than the prices at which trades are authorized under the arrangement – such as (i) the name and title of the director or officer, (ii) the date of adoption or termination of the trading arrangement, (iii) the duration of the trading arrangement, and (iv) the aggregate number of securities to be purchased or sold under the trading arrangement.

Any modification or change to the amount, price, or timing of the purchase or sale of the securities underlying the trading arrangement would constitute the termination of the existing trading arrangement and the adoption of a new trading arrangement.

The SEC did not adopt the proposed requirement for parallel disclosure about issuer trading arrangements.

The SEC believes that these disclosures will enable investors to assess whether and, if so, how registrants monitor trading by their insiders and how the trading arrangements are being used. The SEC observes in this regard that if a report describes the termination of a trading arrangement, the disclosure could provide investors and the SEC "with important information about the potential misuse of inside information such as, for example, if the termination occurs close in time to the release of material nonpublic information" by the registrant.

Annual disclosure of insider trading policies and procedures. Item 408(b) requires registrants to disclose annually whether they have adopted insider trading policies and procedures governing the purchase, sale, and other dispositions of their securities by directors, officers, and employees, or the registrant itself, that are reasonably designed to promote compliance with insider trading laws, rules, and regulations and any applicable listing standards, and, if they have adopted such policies and procedures, to file them as an exhibit. Any registrant that has not adopted insider trading policies and procedures is required to disclose why it has not done so.

The SEC did not adopt the part of its proposal that would have required registrants to describe their insider trading policies and procedures in the report.

Domestic registrants are required to include this disclosure in their annual reports on Form 10-K and proxy and information statements on Schedules 14A and 14C, while foreign private issuers are obligated to provide analogous disclosure in their annual reports on Form 20-F under a new Item 16J of that form.

Executive compensation disclosure regarding option grants. The SEC has amended its executive compensation rules to require registrants to provide additional information on an annual basis about

option grants and certain other equity awards under a new paragraph (x) of Regulation S-K Item 402. The SEC clarifies that the new disclosure requirements also apply to grants of stock appreciation rights and other "similar instruments," which the SEC refers to as instruments that have "option-like" features.

The SEC believes the prior rules have not provided investors with adequate information about a registrant's policies and practices regarding option awards timed to precede or follow the release of material nonpublic information. The new narrative and tabular disclosures are intended to fill this gap and, in particular, to provide investors with "a full and complete picture of any 'spring-loaded' or 'bullet-dodging' option grants during the fiscal year."

Narrative disclosure of policies and practices on timing of awards. Registrants will now be required to describe each year their policies and practices on timing of awards of options and similar instruments in relation to the disclosure of material nonpublic information. The discussion is required to address:

- how the board of directors or compensation committee determines when to grant such awards (such as whether the awards are granted on a predetermined schedule);
- whether, and, if so, how, the board of directors or compensation committee takes material nonpublic information into account when determining the timing and terms of an award; and
- whether the registrant has timed the disclosure of material nonpublic information for the purpose of affecting the value of executive compensation.

The SEC notes that if the registrant is subject to the requirement to present a Compensation Discussion and Analysis (CD&A) in its annual proxy statement, it could present this disclosure in that section of the filing.

Tabular disclosure of options grants to NEOs. The registrant is obligated to supplement the narrative discussion with tabular disclosure if in the last fiscal year (a) it awarded stock options or similar instruments (b) to a named executive officer (NEO) (c) during any period beginning four business days before and ending one business day after the filing of a periodic report on Form 10-Q or Form 10-K, or the filing or furnishing of a current report on Form 8-K, that disclosed earnings information or other material nonpublic information (other than a Form 8-K report that disclosed a material new option grant under Item 5.02(e)). The final rule does not incorporate the proposed amendment that would have included a share repurchase transaction as an event triggering this disclosure.

If tabular disclosure is required, the registrant must provide the following information concerning each such award for the NEO on an aggregated basis in the prescribed format:

- the name of the NEO;
- the grant date of the award;
- the number of securities underlying the award;
- the per-share exercise price;
- the grant date fair value of the award computed using the same methodology that was used for the registrant's financial statements under GAAP; and
- the percentage change in the market value of the underlying securities between the closing market price of the security one trading day prior to and one trading day following the disclosure of the material nonpublic information.

The SEC underscores that the purpose of this disclosure is "to highlight for investors option award grants that may be more likely than not to have been made at a time that the board of directors was aware of material nonpublic information affecting the value of the award."

Issuers are required to present the new disclosure in annual reports on Form 10-K (which may be incorporated by reference to disclosure in the annual proxy statement) and in proxy and information statements relating to director elections, shareholder approval of new compensation plans, and advisory (say-on-pay) votes to approve executive compensation.

The information specified by Item 402(x) must be tagged in Inline XBRL.

Section 16(a) reporting amendments

The SEC has extended to Section 16(a) filings its program for increased transparency about transactions made in reliance on Rule 10b5-1.

Disclosure of Rule 10b5-1(c) transactions on Forms 4 and 5. The SEC has amended Forms 4 and 5 filed pursuant to Exchange Act Section 16(a) to add a "checkbox" which the filer must check if a sale or purchase reported on the form was made pursuant to a trading arrangement intended to satisfy the affirmative defense conditions of Rule 10b5-1(c). The filer also must disclose the date of adoption of the trading arrangement. The SEC believes that the new disclosure will help investors and the public better

discern whether Rule 10b5-1 plans are being used to engage in opportunistic trading on the basis of material nonpublic information.

The SEC did not adopt, as proposed, a second, optional checkbox in which the filer could have disclosed whether the reported transaction was made pursuant to a trading arrangement that did not satisfy Rule 10b5-1(c)'s affirmative defense conditions.

Reporting of bona fide gifts on Form 4. Before its amendment, Exchange Act Rule 16a-3 has permitted a filer to report any bona fide gift of equity securities on Form 5, which must be filed within 45 days after the end of the issuer's fiscal year in which the gift was made. The SEC says it is concerned that the deferred reporting of dispositions of equity securities by gift may allow Section 16 reporting persons "to engage in problematic practices involving gifts of equity securities," including opportunistically timing gifts of securities while aware of material nonpublic information relating to such securities or backdating the gifts to maximize the tax benefits associated with the dispositions.

To address this concern, the SEC has amended Rule 16a-3 to require any Section 16 filer making a disposition of the registrant's securities by gift to report the disposition on Form 4 before the end of the second business day following the date of execution of the transaction, thus eliminating insiders' ability to report dispositions of securities by gift on a year-end Form 5 or on an earlier, voluntary Form 4. *Acquisitions* of securities by gift may still be reported on Form 5.

The SEC reiterates the caution it expressed in the proposing release that insider trading concerns could be raised by a gift of securities by a donor who at the time of the gift is aware of material nonpublic information and who expects the donee to sell the securities before public disclosure of the information. Clarifying that dispositions of securities by bona fide gifts fall within the terms "transfer" and "sale" in Rule 10b5-1(c)(1), the SEC confirms that such gifts may be made under Rule 10b5-1 plans and benefit from the rule's affirmative defense.

Looking ahead

The final rule amendments reflect some notable modifications to the SEC's proposal. The SEC shortened the minimum cooling-off period for director and officer trading arrangements from 120 days to 90 days, imposed a shorter cooling-off period for other traders except the issuer, and provided limited exceptions to the new restrictions on multiple overlapping plans and single-trade plans. The final disclosure amendments do not require disclosure of the pricing terms of director and officer plans and pare back the circumstances that would trigger the tabular presentation of options grant information.

The SEC acknowledges that the final amendments nevertheless could reduce Rule 10b5-1's appeal to some corporate insiders. As the SEC also notes, however, traders choosing not to rely on Rule 10b5-1(c)(1) in purchasing or selling securities may incur other costs. These include their inability to have transactions executed during trading blackout periods, additional costs to determine whether proposed trades may be conducted in compliance with the federal securities laws and SEC rules, and a potential increase in legal liability risk.

The rule amendments will expose the operation of important compliance policies and procedures, as well as related corporate governance practices, to regulatory and investor scrutiny. The SEC intends its disclosure reforms to motivate issuers to take measures to preclude securities transactions that could be seen as allowing their insiders to profit from material nonpublic information. The amendment requiring registrants to disclose whether they have adopted insider trading policies and procedures prohibiting such transactions, for example, can be expected to impel some registrants to adopt such policies and procedures if they have not previously done so.

The amended rules elicit disclosures about the timing and substance of securities transactions that may draw negative attention from investors and the SEC. Accordingly, any preparation for compliance with the new disclosure requirements should be undertaken together with a wide-ranging review of the adequacy of corporate policies and practices that are designed to promote lawful trading activity.

This SEC Update is a summary for guidance only and should not be relied on as legal advice in relation to a particular transaction or situation. If you have any questions or would like any additional information regarding this matter, please contact your relationship partner at Hogan Lovells or any of the lawyers listed in this update.

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