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Quarterly Survey of SEC Rulemaking and Major Court Decisions (July 1, 2024 – September 30, 2024)

*By Kenneth M. Silverman and Kerrin T. Klein**

This issue's Survey focuses on the U.S. Securities and Exchange Commission's ("SEC") rulemaking activities and other decisions relating to the Securities Act of 1933, as amended (the "1933 Act"), the Securities Exchange Act of 1934, as amended (the "1934 Act"), and other federal securities laws from July 1, 2024 through September 30, 2024.

This quarter, the SEC proposed one new rule and approved seven final rules. The final and proposed rules released this quarter continue the SEC's trend of increasing the scope and transparency of information available to investors.

Final Rules

Regulation NMS: Minimum Pricing Increments, Access Fees, and Transparency of Better-Priced Orders

On September 18, 2024, the SEC adopted several amendments to Regulation NMS to modernize certain rules governing the national market system first promulgated in 2005. The adopted amendments focus on reducing transaction costs, enhancing pricing transparency, and refining market operations. These amendments tighten bid-ask spreads, reduce access fee caps, create more transparency in transactional costs involving NMS stocks, and better inform investors and other market participants of better-priced, smaller-sized orders available in the market. Together, the changes to Regulation NMS aim to promote Congress's express interest in ensuring that the markets run fairly and competitively for the benefit of the public and investors.

Rule 612 - Minimum Pricing Increments

Prior to adoption of this final rule, the SEC required that all

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NMS stocks priced at $1.00 or more be quoted in $0.01 minimum pricing increments ("tick sizes"). The SEC set this tick size to prevent market participants from stepping ahead of existing limit orders by insignificant amounts, a practice known as "pennying." Pennying can cause problems for market participants because it disincentivizes them from posting limit orders and consequently slows down liquidity in the market. However, the SEC's rigid $0.01 tick size has constrained pricing for highly liquid stocks, preventing optimal price discovery. This final rule adopted by the SEC thus attempts to strike a balance between encouraging more competitive pricing and maintaining liquidity in the market.

Under this final rule, the SEC has amended Rule 612 of Regulation NMS that will permit certain NMS stocks to be quoted at sub-penny increments of $0.005. Affected stocks will be those trading at a price of $1.00 or more with a time weighted average quote spreads ("TWAQS") of $0.0015 or less. Stocks trading with a TWAQS more than $0.0015 will continue to be quoted at in $0.01 increments.

The SEC's adoption of this final rule adding only one additional tick size is a departure from their proposed rule which would have introduced three additional tick sizes of $0.005, $0.002 and $0.001. In the SEC's Adopting Release, the SEC mentioned its choice to scale back the number of tick sizes was determined after analyzing data and acknowledging legitimate concerns raised by commenters on the proposed rule. Some of those concerns included the possibility of market participants stepping ahead of existing orders through use of the $0.002 and $0.001 tick sizes, and criticism of the increased costs and complexity of integrating these new tick sizes. Ultimately, the SEC determined that the $0.005 tick size sufficiently addressed their goal of increasing liquidity in the market while not introducing any unnecessary costs and unintended consequences into the market.

Assigning Tick Sizes

To determine the tick size for NMS stocks, primary listing exchanges that such stock is listed on must first calculate the stocks' TWAQS over the course of a 3-month evaluation period. As mentioned, an NMS stocks' tick size will be based on such stock's TWAQS. Once this 3-month evaluation period ends, the primary listing exchange will have one month to begin listing such stock's new tick size. Stocks' tick sizes can only change semi-annually. Rule 612(a)(2) of Regulation NMS defines TWAQS as the average dollar value difference between the national best bid and the national best offer during regular trading hours.

Under Rule 612(a)(1) of Regulation NMS, the evaluation periods for a primary listing exchange to determine the TWAQS

for a stock are the (i) three months from January through March of a calendar year, and (ii) three months from July through September of a calendar year. Following an evaluation period, the primary listing exchange has one month to implement any newly assigned tick sizes. This adopted rule lengthens the originally proposed evaluation period which would have been the last month of a calendar quarter. Instead, TWAQS will now be based on a longer period of time to consider data and make TWAQS calculations less sensitive to market distortions that may occur in any given calendar month.

Rule 612(b)(1) of Regulation NMS establishes the semi-annual operative dates for the tick sizes assigned to each NMS stock. Operative dates are the days when an NMS stock will receive its new tick sizes following an evaluation period. The operative dates are the first business day of May following the evaluation period from January through March, and the first business day of November following the evaluation period from July through September.

New NMS Stocks

Under Rule 612(c) of Regulation NMS, all new NMS stocks will be assigned a tick size of $0.01. These stocks may be assigned a sub-penny tick size if they are priced at $1.00 or more and have a TWAQS of $0.0015 or lower following a full evaluation period.

Regulatory Data

To supplement the changes made to tick sizes under Rule 612 of Regulation NMS, the SEC adopted an amendment to the definition of regulatory data in Rule 600(b)(89)(i)(F) of Regulation NMS. The amendment requires the primary listing exchange for each NMS stock to provide a minimum pricing increment indicator to competing consolidators, self-aggregators, and the exclusive security exchange information processors ("SIPs").

The SEC intends for these amendments to Rule 612 to improve price competition, lower transaction costs and reduce unnecessary constraints on liquidity.

Rule 610 - Fees for Access to Quotations and Transparency of Fees

Trading centers have traditionally charged access fees (or provided rebates) to market participants, particularly in a maker-taker model where liquidity takers pay fees, and liquidity providers receive rebates. Until the SEC's recent rule changes, the cap for access fees had been at 30 mils ($0.003 per share) with no adjustments to account for evolving market conditions, which

include new trading practices, technological advancements and reduced costs of processing information. The SEC has reduced the outdated access fee caps to align with the newly adopted smaller pricing increments, prevent pricing distortions and ensure consistency between access fees and the new tick sizes adopted under Rule 612 of Regulation NMS. The SEC's amendments to Rule 610 of Regulation NMS is also intended to ensure that market participants can confidently forecast trading costs.

Reducing Access Fee Cap

Under the final rule, Rule 610(c) of Regulation NMS now requires NMS stocks quoted at $1.00 or more to have an access fee cap of 10 mils ($0.001 per share) and NMS stocks quoted under $1.00 to have a cap of 0.1% of the quotation price.

Requiring All Exchange Fees and Rebates to Be Determinable at the Time of an Execution

Under amended Rule 610(d) of Regulation NMS, national securities exchanges may not impose fees or provide rebates for any execution of an order in NMS stock unless the fee or rebate is determinable at the time of an execution. For these values to be determinable, national securities exchanges that impose fees or provide rebates based on volume thresholds or tiers must set these volumes or tiers based on volume achieved for a prior specified period prior to assessing such fee or rebate.

Transparency of Better-Priced Orders

In 2020, the SEC adopted amendments to Regulation NMS intended to provide market participants with more dependable and prompt information for securities transactions and quotations (the "MDI Rules"). However, as of 2024, these rules have yet to be implemented. As a result, the SEC adopted amendments to expedite implementation of the MDI Rules providing definitions for "round lot" and "odd-lot information." "Round lots" are a standard trading unit for securities and typically refers to stocks traded in a multiple of 100 shares. However, different stock exchanges have their own regulations about round lot sizes that may be less than 100 shares. Odd-lot orders are orders for the purchase or sale of an NMS stock in an amount less than a round lot. Once the amendments are implemented, market participants will be able to see and make round lot orders for stocks at less than 100 shares, and they will be able to see better-priced odd-lot orders. Currently, market participants must purchase proprietary exchange feeds to access information on odd-lot orders. Once these adopted rules take effect, this information will be made widely available to retail investors.

Round Lot Definition

The MDI Rules adopted in 2020 define round lots for NMS stocks based on their average closing price on such NMS stocks' primary listing exchange during the immediately preceding calendar month as follows:

- 100 shares if the average closing price is $250.00 or less per share;
- 40 shares if the average closing price is $250.01 to $1,000.00 per share;
- 10 shares if the average closing price is $1,000.01 to $10,000 per share; and
- 1 share if the average closing price is at least $10,000.01 per share.

Allowing round-lot orders for stocks with an average closing price of at least $250.01 to be below 100 shares will allow exchanges' best bid order and national best bid order for NMS stocks to show market participants the best-priced quotations in the market and provide access to those quotations.

Odd-Lot Information

Once the MDI Rule amending the odd-lot information definition is implemented, investors will freely have access to information regarding the prices and sizes of odd-lot orders priced better than the national best bid and national best offer on the national market exchange. To enable the use of the odd-lot information before the other MDI rules are implemented and increase the utility of odd-lot information, the SEC also adopted amendments to Rule 603(b) and Rule 600(b) of Regulation NMS. Rule 603(b) of Regulation NMS will require that exclusive SIPs collect, consolidate and disseminate odd-lot information. For exclusive SIPs to comply with this rule, every national securities association and national securities exchange must make all data necessary to generate odd-lot information available to the exclusive SIPs. Rule 600(b) of Regulation NMS will expand the definition of "odd-lot information" to include the best odd-lot order, allowing for market participants to stay privy to the best-priced orders on the market.

<u>Effectiveness and Compliance Dates</u>

The amendments adopted under this final rule will become effective 60 days after publication in the Federal Register. Compliance with the amendments to Rule 612 and Rule 610 of Regulation NMS and the round lot definition will be the first business day of November 2025. For odd-lot information, the compliance date will be the first business day of May 2026.

Amendments to Enhance Reporting for Registered Investment Companies

On August 28, 2024, the SEC adopted a final rule amending certain reporting requirements for registered investment companies (funds). The amendments adopted under the final rule include amendments to Form N-PORT and Form N-CEN. The final rule also includes guidance for certain open-end fund liquidity risk management programs.

Currently, registered management investment companies (other than money market funds and small business investment companies) and exchange-traded funds organized as unit investment trusts are required to file periodic reports on Form N-PORT to disclose information about their portfolio holdings on a quarterly basis and are permitted to make such filing within 60 days after the end of the applicable quarter. Form N-PORT contains information about a fund's portfolio as of the end of each quarter; however, the SEC makes information public for only the third month of each quarter, and information relating to the first and second month in a quarter remains confidential.

Due to recent market events, the SEC believes there is a regulatory need for more timely public disclosure of information regarding a fund's portfolio. The SEC also believes that investors benefit from information about a fund's portfolio holdings to assist with making more informed investment decisions.

Form N-PORT Amendments

Pursuant to the final rules, the SEC adopted amendments to Form N-PORT to increase the frequency of filings and the publication frequency of the reports. Specifically, the amendments to Form N-PORT will require funds to file Form N-PORT on a monthly basis, instead of a quarterly basis, and the Form N-PORT will need to be filed within 30 days after the end of each month. The amendments also increase the publication frequency such that each monthly report will be made public 60 days after the end of such month, meaning information will be publicly available for each month instead of information only being public for the third month of a quarter.

In addition, the SEC adopted amendments to Form N-PORT that will (i) require a fund to report certain return and flow information only for the month that the Form N-PORT report covers, rather than for the preceding three months, (ii) allow funds to publicly report the aggregate amount of holdings in the miscellaneous securities category of Form N-PORT each month, while requiring funds to provide more detailed information about the individual holdings in the miscellaneous securities category to the SEC on a nonpublic basis, and (iii) require funds to identify

specifically whether they are reporting a legal entity identifier (known as a LEI) or a Replication Server System Database (known as a RSSD) ID, if available.

The SEC decided not to adopt certain amendments to Form N-PORT that were included in the SEC's proposed rule, such as requiring funds to attach their complete portfolio holdings to Form N-PORT in accordance with Regulation S-X for each month's reporting period. In addition, the SEC did not adopt its proposals to require funds to report swing-pricing related information on Form N-PORT or to aggregate information regarding liquidity classifications of their investments.

Amendments to Form N-CEN

Pursuant to the final rule, the SEC adopted amendments to Form N-CEN which require open-end funds that are subject to liquidity risk management program requirements under Rule 22e-4 (the "Liquidity Rule") under the Investment Company Act of 1940, as amended (the "Investment Company Act"), to report certain information about service providers used to fulfill those requirements. Specifically, such open-end funds will need to report certain identifying information about the liquidity service providers and the asset classes for which the liquidity service providers are used. Also, similar to the amendment to Form N-PORT, such open-end funds will be required to identify specifically whether they are reporting a LEI or a RSSD ID, if available.

Guidance on Certain Open-End Fund Liquidity Risk Management Program Requirements

The SEC issued guidance under the final rule that addresses the Liquidity Rule. The Liquidity Rule was adopted by the SEC in 2016 and requires open-end funds to adopt and implement liquidity risk management programs. The Liquidity Rule was designed to promote effective liquidity risk management, thereby reducing the risk that funds will be unable to meet their redemption obligations and mitigating dilution of the interests of fund shareholders. The guidance issued by the SEC under the final rule specifically relates to the frequency of classifying the liquidity of fund investments, the meaning of "cash" in the Liquidity Rule, and how to determine and review highly liquid investment minimums.

Frequency of Classification

The Liquidity Rule currently requires funds to review liquidity classifications more frequently than monthly if intramonth changes in relevant market, trading and investment-specific considerations are reasonably expected to materially affect one or

more of the fund's investment classifications. Regarding these intramonth changes in investment-specific considerations, the SEC recommended that funds generally should (i) consider reviewing liquidity classifications intramonth if changes in portfolio composition are reasonably expected to materially affect one or more investment classifications and (ii) consider classifying newly acquired investments intramonth if acquiring a particular investment is reasonably expected to result in material changes to the liquidity profile of a fund, particularly changes to the fund's liquidity profile that may cause a shortfall below a fund's highly liquid investment minimum or cause the fund to exceed the Liquidity Rule's limit on illiquid investments.

Meaning of Cash

To determine whether an investment can be classified as highly liquid or moderately liquid, the Liquidity Rule requires a fund to consider the time in which it reasonably expects an investment to be "convertible to cash" (i.e., sold and settled) without significantly changing the market value of the investment. The SEC clarified in the final rule that "cash" means U.S. dollars, and that funds need to consider converting foreign currencies to U.S. dollars when classifying an investment. In addition, the SEC clarified that if a fund does not reasonably expect to be able to convert a foreign currency into U.S. dollars within seven calendar days, then the foreign currency should be classified as an illiquid investment. Further, when a fund converts an illiquid international investment into an illiquid local currency as a step toward reducing the fund's illiquid investments, the SEC would not consider the fund as acquiring the illiquid currency in violation of the Liquidity Rule's prohibition on acquiring illiquid investments in excess of the Liquidity Rule's 15% limit.

Highly Liquid Investment Minimums

The Liquidity Rule requires funds that do not primarily hold assets that are highly liquid investments to have a highly liquid investment minimum. The SEC previously provided guidance on how a fund should determine its highly liquid investment minimum and wanted to reiterate and highlight certain guidance to particularly focus on funds with portfolios that are on the lower end of the liquidity spectrum. Such guidance included, among others, that a fund that invests significantly in less liquid or illiquid investments, such as a bank loan fund, generally should consider establishing a highly liquid investment minimum that is higher than that of a fund that is more liquid.

Effectiveness and Compliance Dates

The amendments adopted under the final rule will become ef-

fective November 17, 2025. However, fund groups with net assets of less than $1 billion will have until May 18, 2026 to comply with the Form N-PORT amendments.

Rules Relating to Registration for Index-Linked Annuities; Amendments to Form N-4 for Index-Linked and Variable Annuities

On July 1, 2024, the SEC adopted final rules amending the form currently used by most variable annuities that will change how registered index-linked annuities ("RILA") and registered market value adjustment annuities ("RMVA", and collectively, with RILA, the "non-variable annuities") and their offerings are registered under the federal securities law.

Move From Forms S-1 and S-3 to Form N-4

Non-variable annuities are annuity contracts offered by insurance companies and sold to retain investors. Currently, issuers of non-variable annuities are required to register their offerings with the SEC on Forms S-1 and S-3. Given that Forms S-1 and S-3 are not specifically tailored to particular kinds of securities and do not contain specific line-item requirements that address relevant disclosures of non-variable annuities and their complex features, the SEC believes that the shift away from Forms S-1 and S-3 to Form N-4 will modernize and enhance the disclosure framework.

Unlike Forms S-1 and S-3, Form N-4 is tailored for annuities and designed to provide investors with key information relating to the contract's provisions, benefits and risk. To further accommodate the disclosures of non-variable annuities on Form N-4, the form will be amended to include, among other things, specific features and risks relating to the potential investment losses and limit on index gains.

Tailored Disclosures

Pursuant to the final rule, both variable and non-variable annuities registered on Form N-4 are permitted to use summary prospectuses. The SEC explained that investors may benefit from the layered disclosure approach offered by a summary prospectus as such layered disclosure approach provides investors directly with key information relating to the contract's terms, benefits and risk in a concise and reader-friendly manner, with further details provided elsewhere. As with variable annuities, the final rule includes two distinct types of summary prospectuses for non-variable annuities:

- an "initial summary prospectus," describing contracts of-

fered to new investors, which must include certain key information about the contract's most salient features, benefits, and risks, presented in plain English in a standardized order; and

- "updating summary prospectuses" to be provided to existing investors in non-variable annuity contracts as a condition to relying on the rule and to include a brief description of certain changes to the contract that occurred during the previous year, as well as a subset of the information required to appear in the initial summary prospectus.

Other Amendments: Accounting Standards, Filing and Communications

The final rule also permits non-variable annuities to provide financial statements that are prepared in accordance with Statutory Accounting Principles, rather than Generally Accepted Accounting Principles. Further, the final rule provides a consistent registration process for issuers on Form N-4 by requiring issuers of non-variable annuities to (i) update their registration statements, (ii) file prospectuses that currently apply to issuers of variable annuities and (iii) pay securities registration fees. Issuers of non-variable annuities are also required to comply with Rule 156 under the 1933 Act ("Rule 156") which provides guidance as to when sales literature is materially misleading under federal securities law.

Effectiveness and Compliance Dates

The effective date for all rules and forms associated with the final rule was September 23, 2024, with a compliance date (other than the amendments relating to Rule 156) of May 1, 2026. Compliance with the amendments to Rule 156 is mandatory as of September 23, 2024.

Qualifying Venture Capital Funds Inflation Adjustment

On August 21, 2024, the SEC adopted a new rule, Rule 3c-7 under the Investment Company Act, to adjust the dollar threshold for defining a "quality venture capital fund" under the Investment Company Act from $10 million to $12 million in aggregate capital contributions and uncalled committed capital. This revised dollar threshold factors in inflation as of December 2023. Accounting for inflation allows more small venture funds to escape classification as a "qualifying venture capital fund" for purposes of compliance with the Investment Company Act, which will reduce costs associated therewith.

The adjustment took effect on September 30, 2024. The final rule provides the SEC with the authority to adjust the threshold for inflation every five years. The next inflation adjustment will take place in November 2029. To ensure that the threshold for venture capital funds continues to reflect economic conditions, the SEC will base their updates on the Personal Consumption Expenditures Index published by the Department of Commerce.

Proposed Rule

Proposal to Implement Financial Data Transparency Act Joint Data Standards

On August 2, 2024, the SEC proposed new rules to implement joint data standards under the Financial Data Transparency Act of 2022 (the "FDTA"). The FDTA amended, among other acts, the Financial Stability Act of 2010 (the "FSA") by adding section 124 to the FSA ("Section 124"). Section 124 directs nine government agencies (the "Agencies"), including but not limited to, the SEC, to issue rules adopting joint standards (the "Joint Standards") for the collections of information by these Agencies.

Under this directive, collections of information that are not regularly reported to the relevant Agency are outside the scope of the FDTA. However, each Agency may choose to further interpret the scope of the FDTA's applicability to its own collections of information in the Agency-specific rulemaking that is to occur two years after the establishment of the Joint Standards.

Currently, the proposed Joint Standards provide for (i) a definition for "collections of information" by reference to the Paperwork Reduction Act of 1995 (the "PRA"), (ii) eight common identifiers related to entities and (iii) a principles-based standard with respect to data transmission, structuring and formatting.

Proposed Joint Standards

Collections of Information

Although the term "collections of information" is not defined by the FDTA, the proposed rule mentions that such term is defined in the PRA. Under the PRA "collections of information" is defined as "(A) the obtaining, causing to be obtained, soliciting or requiring the disclosure to third parties or the public, of facts or opinions by or for any agency, regardless of the form or format, calling for either (i) answers to identical questions posed to, or identical reporting or recordkeeping requirements imposed on, ten or more persons, other than agencies, instrumentalities, or employees of the United States; or (ii) answers to questions posed

to agencies, instrumentalities, or employees of the United States which are to be used for general statistical purposes; and (B) shall not include a collection of information described under section 3518(c)(1) thereunder."

Given that the Agencies are subject to compliance with the PRA and such definition under the PRA is widely understood by public stakeholders and Agencies alike, the Agencies propose to define the term "collections of information" under the FDTA by reference to the definition in the PRA.

Legal Entity Identifiers

Section 124 requires the Joint Standards to include a "common nonproprietary legal entity identifier that is available under an open license for all entities required to report to the Agencies. The Agencies considered many legal entity identifiers and explained that some of the legal entity identifiers that were under consideration, such as the Business Identifier Code, did not meet the FDTA's requirements, including, among others, the nonproprietary and open license requirements.

In narrowing their list of legal entity identifiers to identifiers that satisfy the requirements under Section 124, the Agencies propose the legal entity identifier ("LEI") as set forth by the International Organization for Standardization ("ISO"). In addition to LEI, the Agencies also suggest other common identifiers for items such as swaps and securities-based swaps, financial instruments, geographical locations and currency, amongst others.

Data Transmission and Schema and Taxonomy Format Standards

To standardize the way in which information is transmitted to the Agencies and to promote the exchange of information, the Agencies propose four properties for data transmission, structuring and formatting. Specifically, the proposed properties will:

- render data fully searchable and machine-readable;
- enable high quality data through schemas, with accompanying metadata that clearly define the semantic meaning of the data;
- ensure that a data element or data asset that exists to satisfy an underlying regulatory information collection requirement be consistently identified in associated machine-readable metadata; and
- be nonproprietary or available under an open license.

Under the proposed rule, any data transmission or schema and taxonomy format that has these four properties would be consis-

tent with the Joint Standards. Comments to the proposed rule must be received by October 21, 2024.

Other Significant Rule

Approval of Public Company Accounting Oversight Board Quality Control Standards

On August 20, 2024, the SEC approved two Public Company Accounting Oversight Board ("PCAOB") proposals that update audit standards relating to general responsibilities of the auditor and use of technology-assisted analysis in conducting an audit. In addition, the SEC also approved a proposal amending a PCAOB ethics rule governing the liability of an associated person when they directly and substantially contribute to audit firm violations.

AS 1000

The SEC approved PCAOB's new Auditing Standard ("AS") 1000, *General Responsibilities of the Auditor in Conducting an Audit*, along with related amendments to other PCAOB standards, to reaffirm, consolidate and modernize the general principles and responsibilities of the auditor when conducting an audit. The new AS 1000 reaffirms foundational auditing topics such as (i) the auditor's duty to protect investors through the preparation and issuance of informative, accurate and independent auditor's reports, (ii) the exercise of due professional care, skepticism and judgment when performing audits, and (iii) compliance with ethics and independence rules.

AS 1000 will become effective for audits of financial statements for fiscal years beginning on or after December 15, 2024, except that, for registered public accounting firms that provide audit opinions for 100 or fewer issuers during the calendar year ending December 31, 2024, the rule under AS 1000 relating to the documentation completion date will take effect for audits of financial statements for fiscal years beginning on or after December 15, 2025.

AS 1105 and AS 2301

The SEC approved PCAOB's amendments to AS 1105, *Audit Evidence*, and AS 2301, *The Auditor's Response to the Risks of Material Misstatement*, and conforming amendments, to address the use of technology-assisted data analysis in audit procedures. The SEC noted that these amendments should promote investor protection by enhancing the quality of audits. The amendments to AS 1105 and AS 2301 are principles-based in how they specify and clarify certain existing auditor responsibilities. In particular,

the amendments (i) clarify the description of what constitutes a "test of details", (ii) specify auditor responsibilities when identifying items that require further investigation when performing tests of details, (iii) specify that if the auditor uses an audit procedure for more than one purpose, the auditor should achieve each objective of the procedure, (iv) specify auditor responsibilities for evaluating the reliability of external information provided by the company under audit, (v) emphasize the importance of controls over information technology, and (vi) emphasize the importance of appropriate disaggregation or detail of information to the relevance of audit evidence.

The amendments to AS 1105 and AS 2301 will become effective for audits of financial statements for fiscal years beginning on or after December 15, 2025.

AS 3502

The SEC approved PCAOB's amendment to AS 3502, *Responsibility Not to Knowingly or Recklessly Contribute to Violations*. Existing AS 3502 codifies associated persons' ethical obligation not to contribute to a registered firm's violations of the laws, rules and standards that the PCAOB is charged with enforcing. The amendment to AS 3502 amends the liability standard for actionable contributory conduct by associated persons under AS 3502 from a recklessness standard to a negligence standard. This amendment to AS 3502 will become effective October 19, 2024.

Major Court Decisions

Sixth Circuit Upholds SEC Rule Regulating Private Fund Advisers, Creating Circuit Split

On September 10, 2024, the U.S. Court of Appeals for the Sixth Circuit upheld the U.S. Securities and Exchange Commission's ("SEC" or "Commission") 2022 amendment in which it rescinded parts of its prior 2020 rules for proxy voting advice businesses ("PVABs").

In September 2020, the Commission promulgated a rule (the "2020 Rule") addressing the application of its proxy rules to PVABs. The 2020 Rule implemented three key provisions. First, the 2020 Rule codified the SEC's position that advice given by PVABs constitutes a "solicitation" under Section 14(a) of the Exchange Act. Secondly, for a PVAB to be exempt from Rule 14a's filing and information requirements, it must meet two conditions: (a) disclose certain conflicts of interest in its voting advice, and (b) "adopt policies and procedures reasonable designed" to notify companies of its advice "at or prior to the time when such advice is disseminated to [PVAB] clients,' and to 'provide clients with a

mechanism by which they can reasonably be expected to become aware of any written response" by the company (the "Notice-and-Awareness Conditions"). Third, the 2020 Rule contained an explanatory note, which provided examples of material misstatements deemed unlawful under Rule 14a-9.

The Commission determined that the Notice-and-Awareness Conditions of the 2020 Rule presented a burden to PVABs. Thus, in 2022, the Commission amended the 2020 Rules by rescinding the Notice-and-Awareness Conditions and removing the explanatory note (the "2022 Rescission") to minimize the burden on PVABs.

The U.S. Chamber of Commerce, Business Roundtable, and the Tennessee Chamber of Commerce and Industry (collectively, the "Plaintiffs-Appellants") sued the Commission for procedural and substantive violations of the Administrative Procedure Act ("APA"). The U.S. District Court for the Middle District of Tennessee granted the Commission's motion for summary judgment, holding that the Commission did not act arbitrarily and capriciously. On appeal, the Sixth Circuit considered two questions: whether the rescission of the 2020 Rule was arbitrary and capricious under the APA, and whether the Commission complied with the APA's procedural requirements.

The Sixth Circuit found that the 2022 Rescission was not arbitrary and capricious because the Commission had thoughtfully and thoroughly justified its change in its position, especially given that the Commission conceded that it was changing course, provided a rationale for its change, and explained why the Commission believed that the 2022 Rescission would mitigate the burdens faced by PVABs. Similarly, the Sixth Circuit held that the Commission adopted the 2022 Rescission would mitigate the burdens faced by PVABs. Similarly, the Sixth Circuit held that the Commission adopted the 2022 Rescission for a "different and improved policy balance." The Sixth Circuit further held that the Commission adequately analyzed economic consequences of the 2022 Rescission as required under the Exchange Act.

The Sixth Circuit also rejected Plaintiffs-Appellants' procedural argument that the thirty-one-day notice and comment period for the 2022 Rescission violated the APA because it failed to provide interested parties with a meaningful opportunity to comment.

This Sixth Circuit decision follows a recent June 2024 ruling where the U.S. Court of Appeals for the Fifth Circuit vacated the same amendment. *See National Association of Manufacturers v. United States Securities and Exchange Commission*, 105 F.4th 802, Fed. Sec. L. Rep. (CCH) P 101885 (5th Cir. 2024). These two conflicting opinions now present a Circuit split.

U.S. Chamber of Commerce v. SEC, Case No. 23-05409, in the U.S. Court of Appeals for the Sixth Circuit.

Dismissal of Preferred Stock Owners' Claims Affirmed by Fourth Circuit for Failure to State Viable Claims

On September 4, 2024, the U.S. Court of Appeals for the Fourth Circuit held that preferred stock owners ("Plaintiffs-Appellants") of Cedar Realty Trust, Inc., (the "Company") failed to state viable claims stemming from a series of transactions that resulted in the Company's acquisition by Wheeler Properties ("Wheeler"), the Company's delisting and payment to common stockholders for their shares, and no payment to the Company's preferred stockholders. Plaintiffs-Appellants alleged that the Company and its directors breached their contractual and fiduciary duties to preferred stockholders, and that Wheeler tortiously interfered with their contractual rights and aided and abetted the Company's breach of fiduciary duty. The "U.S. District Court for the District of Maryland" granted Defendants-Appellees' motion to dismiss with prejudice, and the Fourth Circuit affirmed.

The Fourth Circuit first affirmed dismissal of Plaintiffs-Appellants' breach of contract claim against the Company. The Fourth Circuit held that the Company properly adhered to the unambiguous language of its Articles of Incorporation, here the relevant contract, which provided for conversion rights in the event of a change of control where the "acquiring or surviving entity" does not have publicly traded shares. Since Wheeler's common stock remained publicly traded after the acquisition, there was no change in control pursuant to the Articles of Incorporation and the Company did not breach any obligation to provide its preferred stockholders with an opportunity to exercise their conversion right.

The Fourth Circuit next affirmed dismissal of Plaintiffs-Appellants' breach of fiduciary duty claim against the Company's directors. The court held that "preferred stockholders are owed fiduciary duties only 'when they do not invoke their special contractual rights and rely instead on a right shared equally with the common stock.' " But when preferred stockholders invoke preferential rights, directors do not owe them any fiduciary duties, since their rights are contractual. Here, the Fourth Circuit held that the Company's Articles of Incorporation alone define the scope of duty owed to the preferred stockholders, and the Plaintiffs-Appellants failed to plausibly allege that those duties were violated.

Plaintiffs-Appellants also brought claims against the acquiring company, Wheeler, for aiding and abetting breach of fiduciary duty and tortious interference with contract. The Fourth Circuit court affirmed the district court's dismissal of both claims as lacking an underlying breach of contract or breach of fiduciary duty to support a tort claim.

The Fourth Circuit directed the following wisdom to Plaintiffs-Appellants as it concluded its decision:

> All of us have wished that we could turn back the clock and not make a purchase we've come to regret. Given the depressed value of the preferred stock, it makes sense why Plaintiffs wish that now. But courts are not time machines for disgruntled buyers. We resolve legal claims. And Plaintiffs do not adequately allege that Defendants violated any legal right or duty—they only allege that they regret the terms they bargained for.

Kim v. Cedar Realty Trust, Inc., Case No. 23-01905, in the U.S. Court of Appeals for the Fourth Circuit.