CARTER LEDYARD

our resources

Significant Corporate and Securities Law Developments in 2023

February 28, 2024

During the last year, there were numerous important Securities and Exchange Commission ("SEC"), regulatory and other developments affecting our clients and their counsel. We have set forth below summaries of the following developments that took place during 2023.

1. Listed Companies Are Required to Have a Written Policy on Compensation Clawbacks.
2. New Cybersecurity Disclosure Requirements Now Effective.
3. Shortened Deadlines for Filing Schedule 13D Amendments Now in Effect; Schedule 13G to Follow.
4. New Filing Required Under the Corporate Transparency Act.
5. FTC Increased Enforcement Against Interlocking Directorates Through Section 8 of the Clayton Act.
6. Foreign Extortion Prevention Act Enacted, Expanding Federal Criminal Liability to Non-U.S. Officials.
7. SEC Shortened the Securities Transaction Settlement Cycle to T+1.
8. New Short Sale Disclosure Rules.
9. Form 144 Filing Hours Extended.
10. New Conditions and Disclosure Requirements for Rule 10b5-1 Insider Trading Plans.
11. Exemption for M&A Brokers Codified.
12. Share Lending Disclosure Rules Adopted.
13. Share Repurchase Rule Amendments Adopted Then Vacated.
14. Digital Tokens Are Not Securities – but Promises to Enhance Their Value Make Them So, One Court Found.
15. The Second Circuit Confirms Syndicated Term Loan in Kirschner Is Not a "Security".

1. Listed Companies Are Required to Have and Apply a Written Policy on Compensation Clawbacks

Since December 1, 2023, companies listed on national securities exchanges are required, under exchange rules, to have and disclose written policies for the "clawback" of incentive-based compensation when applicable performance measurements turn out not to have been achieved, as a result of accounting restatements. Erroneous payments must be recovered even if there was no misconduct or failure of oversight on the part of an individual executive officer.

An issuer could be subject to delisting if it does not adopt a clawback policy that complies with the listing standard, disclose the clawback policy and the application of the policy in accordance with SEC rules, or enforce the clawback policy's recovery provisions.[1]

An issuer is required to file its clawback policy as an exhibit to its annual report on Form 10-K, Form 20-F or Form 40-F. New checkboxes on the cover pages of Form 10-K, Form 20-F and Form 40-F require issuers to indicate separately: (a) whether the financial statements included in the filing reflect correction of errors to previously issued financial statements, and (b) whether any of those error corrections are restatements that required a recovery analysis of incentive-based compensation received by any of the issuer's executive officers during the relevant recovery period. The issuer is also required to disclose in its annual report or proxy statement how it has applied its clawback policy.

Amounts recovered under an issuer's clawback policy should reduce the amount reported in the applicable compensation table column and the "total" column for the fiscal year in which the amount recovered initially was reported and the recovery must be identified by footnote. If an award is subject to both time-based and performance-based vesting conditions, it is considered received upon satisfaction of the performance-based conditions, even if the award continues to be subject to time-based vesting conditions.

The rules apply to all current or former "executive officers," with a three-year lookback. The clawback recovery is not limited to the issuer's top five "named executive officers." "Executive officers include the issuer's president, principal financial officer, principal accounting officer ("PAO") or controller if there is no PAO, any VP of the issuer in charge of a principal business unit, division or function (e.g., sales, administration or finance), any other officer or person who performs a policy-making function for the issuer.

Practice Notes:

- Listed company chief legal officers and chief compliance officers should assure themselves that their companies have adopted and disclosed a compliant policy.
- Chief financial officers should confirm that their companies stand ready to apply the policy, and
- Disclosure committees should make sure that the new disclosure requirements have been added to the matrix of required disclosure items.

The New York Stock Exchange ("NYSE") listed companies that have failed to adopt a clawback policy within 60 days of the effective date of the standards, i.e., January 30, 2024, are required to issue a press release identifying their failure to do so, the reasons for it, and, if known, the date by which they expect to be in compliance. Nasdaq-listed companies that have failed to adopt a clawback policy by the same date, should submit a plan of compliance to Nasdaq staff within 45 days to have access to cure rights, in accordance with existing Nasdaq procedures.

The clawback listing requirements for national securities exchanges took effect on October 2, 2023, a year after the SEC adopted rules implementing a provision of the Dodd-Frank Act. That Dodd-Frank provision added Section 10D of the Securities Exchange Act of 1934 (the "Exchange Act").

2. New Cybersecurity Disclosure Requirements Now Effective

New annual reporting rules require issuers, beginning with December 2023 fiscal year filers, to provide material information regarding cybersecurity risk management, strategy and governance and the updating requirements include prompt disclosure of material cybersecurity incidents. The new reporting rules for cybersecurity are contained in Form 10-K, Form 20-K, Form 8-K and Form 6-K.

The SEC adopted the new rules on July 26, 2023, which included the addition of a new Regulation S-K Item 106. This item requires issuers to describe their processes, if any, for assessing, identifying, and managing material risks from cybersecurity threats, as well as the actual or reasonably likely material effects of risks from cybersecurity threats and previous cybersecurity incidents. Item 106 requires issuers to describe the board of directors' oversight of risks from cybersecurity threats and management's role and expertise in assessing and managing material risks from cybersecurity threats.[1]

Form 8-K

U.S. issuers must provide the required cybersecurity incident disclosure on Form 8-K within four business days after the issuer determines an incident to be material.

Form 6-K

For foreign private issuers ("FPIs"), as with other material events, the cybersecurity incident disclosure must be furnished on Form 6-K promptly after the incident is actually disclosed or is required to be disclosed or publicized in a non-U.S. jurisdiction, to any stock exchanges, or to security holders. Moreover, Form 20-F is being amended to require FPIs to make similar periodic disclosure to S-K Item 106.

Form 20-F

For FPIs, Form 20-F was amended to require FPIs to make similar periodic disclosure to that required under S-K Item 106.

Form 40-F

For Canadian issuers filing under the Multijurisdictional Disclosure System ("MJDS"), the SEC agreed not to amend Form 40-F, maintaining that Canadian issuers eligible to use MJDS should be permitted to follow their Canadian disclosure standards, consistent with other disclosure requirements for those issuers.

The New Form 10-K and Form 20-F disclosures relating to cybersecurity risks became effective beginning with annual reports for fiscal years ending on or after December 15, 2023. Corresponding new Form 8-K and Form 6-K disclosure obligations became effective December 18, 2023 (except for smaller reporting companies, for which the new 8-K/6-K requirements will only take effect on June 15, 2024.)

DOJ Guidelines

The new rules provide for delayed reporting of cybersecurity incident disclosures described above that would pose "a substantial risk to national security or public safety," contingent on a written notification by the Attorney General. The Attorney General may take into consideration other Federal or other law enforcement agencies' findings.

On December 12, 2023, the Department of Justice (the "DOJ") issued guidelines describing the process an issuer should follow to obtain a delay in reporting and the procedures the Attorney General will use to evaluate whether a delay is warranted. According to the guidelines, if believed to apply, issuers need to contact the FBI and convey in their report a concise description of the facts forming the basis of the issuer's belief that the cybersecurity incident disclosure required under Form 8-K or 6-K may pose a substantial risk to national security or public safety.[2]

FPIs are not part of the delaying process through the DOJ which relates to the four business days' requirement of Form 8-K. Generally, while FPIs may choose to follow the 8-K disclosure model, Form 6-K disclosure of a cybersecurity incident is required only if an FPI first makes (or is required to make) a home jurisdiction disclosure of a cybersecurity incident, and that information is material.

Practice Notes:

- Disclosure review committees should have Chief Information Security Officers confirm that Form 10-K annual reports accurately and fully identify cybersecurity risks and procedures.

- Foreign private issuers should be prepared to make U.S. securities filings as quickly as possible after meeting home country requirements.

- Make sure that the legal department has made preparations to open a channel of communication to the FBI in case an incident occurs that provides reason to delay SEC reporting.

3. Shortened Deadlines for Filing Schedule 13D Amendments Now in Effect; Schedule 13G to Follow

Beginning February 5, 2024, the deadline for filing initial Schedule 13D beneficial ownership reports has been shortened to five business days (from 10 days), and for amendments to two business days. However, filers now have until 10 p.m. on the date of the deadline to file.

Beginning September 30, 2024, for certain Schedule 13G filers (i.e., qualified institutional investors and investors that acquired securities before the issuer was required to register under the Exchange Act), the initial filing deadline, will be 45 days after the end of the calendar quarter (rather than after the end of the calendar year) in which the investor beneficially owns more than 5% of the covered class. For other Schedule 13G filers (i.e., passive investors), the amendments will shorten the initial filing deadline to five business days (from 10 calendar days).[1]

Additionally, for all Schedule 13G filers, amendments must be filed generally 45 days after the calendar quarter in which a material change occurred (rather than after the calendar year) However, a qualified institutional investor must file an amendment within five business days (reduced from 10 calendar days) after the end of a month in which its beneficial ownership has exceeded 10% or beneficial ownership has increased or decreased by more than 5%. By contrast, passive investors have a deadline of two business days after crossing the 10% threshold or increasing or decreasing holdings by more than 5%.

The adopting release makes clear that disclosure requirements apply to all derivatives that use company equity securities as reference securities, including cash-settled derivatives, whether or not originated, offered or sold by the issuer (applying new guidance similar to that for security-based swaps).

The adopting release also provides guidance regarding the formation of a group that is subject to Schedule 13D filing requirements. Concerted action by two or more persons for the purpose of acquiring, holding, or disposing of securities of an issuer may be sufficient to constitute them as a group under Sections 13(d)(3) and 13(g)(3) of the Exchange Act, even without an explicit agreement between them. The determination of group statutes will be based on an analysis of all the relevant facts and circumstances. Further guidance clarifies that a group will be deemed to have acquired any securities acquired by any member of the group after its formation (but that intra-group transfers would not constitute an additional acquisition by the group).

Practice Notes:

- Companies should establish processes to assure that persons responsible for filings can be notified immediately when a change occurs in the company’s ownership of another issuer’s securities or related derivatives – so that they can meet the abbreviated filing deadlines.

- Make sure that individuals engaged in investment functions do not become involved in activities that could be viewed, in retrospect, as coordinated with others.

The SEC adopted this change on October 10, 2023, along with shortened deadlines for Schedule 13G reporting that apply beginning September 30, 2024. Schedule 13D and 13G filings must be made after December 18, 2024, using structured, machine-readable data language.

4. New Filing Required Under the Corporate Transparency Act

Beginning January 1, 2024, all companies formed by a filing with the secretary of state of a U.S. state and non-U.S. companies registered to do business in the U.S. must electronically report their beneficial owners to the U.S. Treasury Department's Financial Crimes Enforcement Network ("FinCEN") within 90 days of formation (unless exempt, as described below). Affected companies that already existed before January 1, 2024 must submit an initial report by January 1, 2025. Companies formed after January 1, 2024 will have 30 days, instead of 90, to file. Reports must be filed through FinCEN's free e-filing online portal either by submitting a web-based version or uploading a PDF version of the reporting form. Reported information will be stored in FinCEN's non-public database accessible by national security and law enforcement agencies, financial institutions, and non-U.S. enforcement agencies when shared under certain circumstances. Penalties for failing to file initial and updated reports include charges of $500 per day up to $10,000 and imprisonment up to two years.[1]

Exempt companies include SEC-reporting companies, banks, insurance companies and public accounting firms, sole proprietorships, common law trusts and general partnerships. A beneficial owner is any individual who (1) directly or indirectly owns or controls at least 25% of the reporting company's ownership interests, or (2) exercises substantial control over the reporting company, such as senior officers with substantial influence over important decisions. A company applicant is the individual who (1) files the document creating or registering the reporting company or (2) is primarily responsible for directing or controlling the filing of such document (no more than two company applicants may be reported).

Reporting companies must provide their full legal name, trade or d/b/a names, U.S. principal place of business address or primary location in the U.S., formation or registration jurisdiction, and IRS taxpayer identification number or non-U.S. tax identification number and its issuing jurisdiction. For each individual beneficial owner and company applicant, reporting companies must provide the full legal name, date of birth, residence address (beneficial owners) or business address (company applicants), and an image and its unique ID number from a U.S. passport, state driver's license, or government-issued ID or, if the individual does not possess any of the aforementioned documents, a non-U.S. passport. The person submitting the report must provide name and email address and certify on behalf of the reporting company that the provided information is true, correct, and complete.

Practice Note:

- A subsidiary of an exempt entity that is only partially-owned by that entity is not exempt. Make sure that joint ventures and investment entities are tested individually for a valid exemption.

The Corporate Transparency Act ("CTA") was adopted in 2021 but is effective beginning January 1, 2024.

5. FTC Increased Enforcement Against Interlocking Directorates Through Section 8 of the Clayton Act

Section 8(a)(1) of the Clayton Act prohibits a person or entity from simultaneously serving as a director or board-appointed officer at two competing corporations, subject to certain exceptions. The ban only applies if the two corporations are engaged in actual (not potential) competition in interstate commerce and meet certain financial thresholds. Unlike many antitrust statutes requiring proof of anticompetitive harm, Section 8 imposes strict liability. This means that the mere existence of an interlock alone constitutes a violation of federal law.

On October 10, 2023, the Federal Trade Commission ("FTC") issued an order affirming a consent agreement to unwind a set of arrangements between two natural gas businesses, QEP Partners, LP ("Quantum") and EQT Corporation ("EQT"), alleging risks of harm to competition from information sharing and a board "interlock" that it claimed violated Section 8 of the Clayton Act. Notably, Section 8, in its wording, prohibits interlocks among competing "corporations." However, Quantum operates as a limited partnership, diverging from the typical corporate structure covered by this provision. The consent agreement and FTC order confirming it: (i) mark the FTC's first formal enforcement of Section 8 in 40 years, (ii) represent a broadened (and innovative) application of Section 8 because it is the first Section 8 enforcement action involving an entity that is not a corporation, and (iii) continue the FTC's practice of using consent decrees to pursue its expansive interpretation of the prohibition of "unfair methods of competition" in Section 5 of the FTC Act.[1]

On November 10, 2022, the FTC also indicated its intention to use its authority in regulating unfair methods of competition under Section 5 of the FTC Act. This move was aimed at initiating enforcement actions against interlocking directorates that do not fall under other antitrust laws.

As of January 2024, an interlocking directorate is exempt from Section 8 when either corporation has less than USD $48,559,000 in total capital, surplus, and undivided profits; or the competitive sales of: (i) either corporation are less than USD $4,855,900, (ii) sales of either corporation's goods or services that are competitive with the others are less than 2% of either's total sales or less than 4% of each company's total sales.

Practice Notes:

- To mitigate the risk of exposure to Section 8 investigations and penalties, corporations should assess their corporate governance compliance programs, especially following changes in board composition.

- Public companies should add a question about interlocking directorates in their directors and officers' questionnaires.

6. Foreign Extortion Prevention Act Enacted, Expanding Federal Criminal Liability to Non-U.S. Officials

On December 22, 2023, the Foreign Extortion Prevention Act ("FEPA") was enacted as part of the annual National Defense Authorization Act. FEPA criminalizes demand-side bribery by non-U.S. officials who "corruptly demand, seek, receive, accept, or agree to receive or accept, directly or indirectly, anything of value," in exchange for an improper business advantage, from: (a) any person while in the territory of the U.S., (b) a U.S. issuer or (c) a domestic concern, i.e., any U.S. citizen or resident, or any entity with a principal place of business in the U.S., or which is organized under the laws of the U.S.[1]

FEPA's definition of "foreign official" generally aligns with the FCPA definition but expands it in mainly two ways: (a) including not only those individuals acting in an official governmental capacity, but also those acting in an "unofficial capacity," and (b) including "any senior foreign political figure," covering certain current or former senior non-U.S. officials (whether elected or not), politicians, executives of government-owned commercial enterprises and their family members, close associates and businesses.

Finally, like the FCPA, FEPA requires a *quid pro quo*. That is, the corrupt demand by a non-U.S. official must be in exchange for: (1) "being influenced in the performance of any official act", (2) "being induced to do or omit to do any act in violation of the official duty of such non-U.S. official or person", or (3) "conferring any improper advantage, in connection with obtaining or retaining business for or with, or directing business to, any person."

Penalties under FEPA include fines up to the greater of $250,000 or three times the value of the bribe, and/or imprisonment of up to 15 years.

7. The Securities Transaction Settlement Cycle Shortened to T+1

Starting May 28, 2024, U.S. registered broker-dealers must settle trades on the next business day (T+1) unless the parties to the trade expressly agree otherwise or an exemption is available. As of this time, non-U.S. regulators have not followed the lead of the SEC and still will allow T+2 settlement. Broker-dealers that must deliver securities, to settle one leg of a trade, in T+1, but only will receive the same securities on T+2, generally will have to fund the gap.[1]

The SEC carried forward exemptive relief, which it had issued in 1995, if among other conditions there are no transfer or delivery facilities for the security in the U.S. or if annual trading in the security in the U.S. constitutes less than 10% of worldwide trading volume. Trading, and trading data, has fragmented over the intervening 29 years, which limits the practical value of the exemption. The SEC staff is considering an update to make the exemption more practical.

Also effective May 28, 2024, broker-dealers generally must complete allocations, confirmations and affirmations by the end of the trade date (T+0) and must update their compliance procedures accordingly. Investment advisers will be required to record allocations and confirmations and keep those records.

These rules for T+1 Settlement and T+0 for broker-dealers completion of allocations, confirmations and affirmations are effective May 28, 2024.

8. New Short Sale Disclosure Rules

Institutional investment managers that meet or exceed certain reporting thresholds will be required to report their short position and activity data monthly under new Rule 13f-2 and Form SHO. Form SHO will be due 14 days after each calendar month end and will require information related to:

- The end-of-month gross short position, and
- For each individual settlement date during the calendar month, the net activity in the reported equity security.

Although these submissions will be kept confidential, the SEC intends to release summarized data on short sales, with a month's delay.

Additionally, the SEC amended the consolidated audit trail ("CAT") National Market System Plan (the "CAT NMS Plan") governing the CAT to require detailed reporting on short sales by market makers, including whether such sales are part of legitimate market-making activities.

Compliance with Rule 13f-2 and Form SHO will become mandatory on January 2, 2025, with the SEC beginning to disclose collective short sale data in April 2025. The amendment to the CAT NMS Plan will be enforced from July 2, 2025.

9. Form 144 Filing Hours Extended

The SEC extended, until 10:00 p.m. Eastern Time, the hours for filing Form 144. Rule 144 permits the resale of restricted securities, subject to the satisfaction of the Exchange Act's conditions. If the seller is an affiliate of the issuer, then among other conditions the seller must, on the same day as placing their sell order, file Form 144 electronically on EDGAR. Previously, the last time to file Form 144 had been 5:30 p.m. The change, in the form of an amendment to Regulation S-T, became effective March 20, 2023.

10. New Conditions and Disclosure Requirements for Rule 10b5-1 Insider Trading Plans

Rule 10b5-1 plans are widely used by officers and directors of issuers who may become aware of material nonpublic information ("MNPI") but still wish to purchase or, more typically, to sell shares on a predetermined basis. The plans provide an affirmative defense from insider trading liability for trades even when the insider is aware of MNPI, but only if the trader was not aware of MNPI when the trader adopted the plan, and the other conditions of the rule are satisfied.

The SEC amended the conditions of the plans, and added new disclosure requirements relating to the plans:

- A minimum cooling-off period, starting when a plan is adopted or modified (other than for the issuer), now must expire before trading commences. For a director or officer, the cooling-off period expires after 90 days or, if later, two business days after the issuer files a Form 10-Q or other periodic report covering the period in which the plan was adopted.
- Persons (other than the issuer) now may adopt just one plan, to cover all classes of securities of the issuer, except sell-to-cover arrangements to satisfy tax withholding obligations incident to the vesting of certain equity awards and specified other exceptions.
- In any 12-month period, a trader now may adopt just one "single trade" plan (i.e., where all the shares covered by the plan are sold in one transaction), except for sell-to-cover arrangements.

- Directors and officers must certify that they are adopting plans in good faith and not as part of a plan or scheme to evade the prohibitions of the Exchange Act and that they are not aware of any MNPI when they adopted the plan.

- A U.S. issuer must disclose, in Form 10-Q or Form 10-K, the material terms of each plan that is adopted or modified by any director or officer during the quarter covered by the report.

- Issuers must disclose their insider trading policies and procedures in their annual reports (on Form 10-K or Form 20-F). This disclosure must be provided for the first time on Form 10-K or 20-F for fiscal years ending December 31, 2024, although it will likely be provided earlier by many issuers. If an issuer has not adopted insider trading policies and procedures, it must explain the reasons why it has not.

- A person who files a Form 4 or 5 must check a new box to indicate whether the reported transaction was made under a Rule 10b5-1 plan and state the date that such plan was adopted.

The changes took effect on February 27, 2023.

Practice Notes:

- If it has not already done so, companies should adopt "insider trading policies and procedures" and schedule a Form 10-K (or 20-F) filing.

- Distribute the new Form 4 (and 5) formats to all officers and directors and suggest that older forms be discarded.

- Make sure that models for 10b5-1 plans include forms of certification to be produced when plans are submitted for adoption.

11. Exemption for M&A Brokers Codified

Congress amended the Exchange Act to codify an exemption for a person who effects securities transactions solely in connection with the transfer of ownership of privately held companies.

An "M&A broker" is a person engaged in the business of effecting securities transactions "solely in connection with the transfer of ownership of an eligible privately held company," provided, among other conditions, that the buyer will control the eligible privately held company by any means. There is a presumption of control if the buyer can vote or direct the sale of 25% of a class of voting shares.

An "eligible privately held company" is a company that, in the immediately preceding fiscal year, had:

- No class of securities registered or required to be registered under Section 12 of the Exchange Act, and

- EBITDA less than US$25 million or gross revenues less than US$250 million.

A person that satisfies the conditions of the exemption need not register as a broker-dealer under the Exchange Act.

As a result of the new exemption, the SEC withdrew its 2014 no-action exemption letter, which had somewhat similar criteria.

The exemption does not apply to state broker-dealer registration requirements. Activities that are exempt from federal registration may nonetheless require registration under the laws of some states.

The exemption, codified as new Section 15(b)(13) of the Exchange Act, took effect on March 29, 2023.

12. Share Lending Disclosure Rules Adopted

Securities lending is the market practice by which securities are transferred temporarily from one party, a securities lender, to another, a securities borrower, for a fee. The typical lender is a pension fund or mutual fund with a large, static, unleveraged portfolio. The ultimate borrower typically is a hedge fund that needs to cover a short position and accesses the lending market through their prime broker.

In an attempt to increase transparency in the securities lending market, the SEC adopted new Rule 10c-1a. Compliance will be mandatory starting January 2, 2026.

The rule requires covered persons to disclose to FINRA certain details regarding covered securities loans:

- "Covered person" includes (i) a person that agrees to a covered securities loan on behalf of a lender; (ii) a non-intermediary that acts as a lender in a covered securities loan; or (iii) a broker when borrowing fully paid or excess margin securities,
- "Covered securities loan" means a transaction in which any person lends a reportable security to another person, and
- "Reportable security" means a security for which information is required under certain reporting regimes specified in the rule, such as the CAT NMS Plan or FINRA's "TRACE" reporting regime,

with exclusions for:

- Positions at a registered clearing agency that result from central counterparty services or central depository services, and
- The use of margin securities by a broker or dealer unless such broker or dealer lends such securities to another person.

There is no *de minimis* exclusion.

Covered persons must report these details to FINRA at the end of each day on which any covered securities loan occurs, and FINRA will then publish certain details of the covered securities loan the morning of the next business day.

A covered person will have to report to FINRA the following information, which will be made public: the name of the issuer; the ticker symbol, ISIN or other security identifier; the date and time the loan was effected; the name of the platform where the loan was effected; the amount of the loan; the type of collateral used to secure the covered securities loan; the rebate rate or any other fee or charges in connection with a covered securities loan collateralized with cash; the lending fee, rate or any other fee or charges in connection with a covered securities loan not collateralized with cash; the percentage of the collateral to the value of the reportable securities loaned required to secure such covered securities loan; the termination date of the covered securities loan; and the type of borrower (i.e., a broker or dealer, a clearing agency, a bank, etc.).

A covered person also will have to provide FINRA with the following information, which will not be publicized by FINRA: the legal name of each party to the covered securities loan; if the person lender is a broker or dealer and the borrower is its customer, whether the security is loaned from a broker's or dealer's securities inventory to a customer of such broker or dealer; and whether the covered securities loan is being used to close out a fail to deliver.

13. Share Repurchase Rule Amendments Adopted Then Vacated

The Court of Appeals for the Fifth Circuit vacated certain amendments, which the SEC had adopted, to rules relating to share repurchase programs. The amendments would have required issuers to disclose:

- Daily repurchase activity periodically, in tabular form,

- Whether officers or directors traded around the time of the announcement of the program,
- Narrative disclosure of the program, including its objectives and rationale, and
- The adoption and termination of Rule 10b5-1 trading plans, as well as material terms of such plans.

The amendments became effective on July 31, 2023. However, as the result of a lawsuit, the Fifth Circuit remanded them to the SEC to address identified defects by November 30, 2023. The SEC was unable to correct the defects and on December 19, 2023, the Fifth Circuit issued a final opinion vacating the amendments entirely.

14. Digital Tokens Are Not Securities – But Promises To Enhance Their Value Make Them So, One Court Found

Are transactions in digital assets regulated by the federal securities laws? The answer depends more on the details of the transaction than on the asset, opined the District Court for the Southern District of New York in *SEC v. Ripple Labs, Inc.*[1]

Ripple raised more than $1.3 billion by selling "XRP tokens," a type of digital asset, without registering the offering under the Securities Act. The SEC sued. The court applied the Supreme Court's *Howey* test (*SEC v. W.J. Howey Co.*, 328 U.S. 293 (1946)) for when an investment contract is a security and held that XRP tokens are like the orange groves involved in *Howey*, i.e., not themselves securities, but when combined with promises by the selling entity to enhance their value (e.g., managing the grove in *Howey*, developing additional uses, in *Ripple Labs*), an "investment contract," and hence a "security," could be created that would be subject to Securities Act regulation (depending on the economic reality and totality of circumstances).

Ripple's marketing efforts created, in some institutional purchasers, a reasonable expectation that Ripple would use the capital received from the sales to improve the market for XRP tokens and develop uses for them and thereby increase the value of XRP tokens, the court found. Offers and sales of XRP tokens in this manner, the court held, required registration under the Securities Act.

At the same time, Ripple also offered and sold XRP tokens to other purchasers in transactions, such as on-exchange sales, that involved no such communications and thus, the court held, were not subject to the Securities Act. The anomalous result of the court's rulings is that institutional investors can be entitled to more protections than retail investors.

15. The Second Circuit Confirms Syndicated Term Loan in Kirschner Is Not a "Security"

On August 24, 2023, the U.S. Court of Appeals for the Second Circuit issued its decision in *Kirschner* v. *JPMorgan Chase Bank*, *N.A. et al.*, rejecting the plaintiff's argument that the notes issued to evidence a syndicated term loan should be treated as securities.

In *Kirschner*, multiple banks made a syndicated loan of $1.775 billion to Millennium Laboratories LLC, which later faced significant legal issues leading to bankruptcy. The trustee of a trust created to for the benefit of creditors sued the banks, alleging violations of state securities laws for making misrepresentations to investors, including falsely assuring investors that Millennium had no exposure to material litigation. The defendants sought dismissal, arguing that the notes issued in a syndicated bank loan were not "securities" under state securities laws.

The Second Circuit applied the "family resemblance" test from the Supreme Court's decision in *Reves* v. *Ernst & Young* 494 U.S. 56 (1990). The "family resemblance" test evaluates four factors to determine whether a note was issued in an investment context, thus constituting a security, or in a consumer or commercial context, thus not constituting a security. The four factors are: (i) the motivations that would prompt a reasonable seller and buyer to enter into the transaction, (ii) the breadth of the plan of distribution of the instrument, (iii) the reasonable expectations of the investing public, and (iv) whether some factor, such as the existence of another regulatory scheme, significantly reduces the risk of the instrument, thereby rendering application of the federal securities act laws as unnecessary.

The Second Circuit determined that, although the first factor leaned towards considering the loan as a security due to the mixed motivations of the parties, the remaining factors weighed against this classification. The second factor weighed against finding that the loan was a security because the notes "were unavailable to the general public by virtue of restrictions on assignments." The third factor did not support the loan being classified as a security because the sophisticated entities that purchased the notes "were given ample notice that the notes were…loans and not investments in a business enterprise." Finally, the fourth factor weighed against concluding that the loan was a security because the loan was "secured by collateral and federal regulators have issued specific policy guidance addressing syndicated loans." On balance, the court determined that the syndicated loan closely resembled loans issued by banks for commercial purposes, which the Secured Circuit previously recognized were not securities in *Banco Espanol de Credito v. Security Pacific National* Bank, 73 F.2d 51 (2 Cir. 1992).

---

1 For the full text of our client advisory on this topic, please see:
FAQ Re: Incentive Based Compensation – Understanding the New Clawback Rules | Carter Ledyard & Milburn LLP (clm.com)
For the full text of the SEC rule, please see: https://www.sec.gov/rules/final/2022/33-11126.pdf.

2 For the full text of our client advisories on this topic, please see:
New Cybersecurity Disclosure Rules for Public Companies: Update | Carter Ledyard & Milburn LLP (clm.com)
SEC Adopts New Cybersecurity Disclosure Rules for Public Issuers | Carter Ledyard & Milburn LLP (clm.com)
New SEC-Proposed Rules Emphasizing Cybersecurity Disclosures and Governance | Carter Ledyard & Milburn LLP (clm.com)
For the full text of the SEC rule, please see:
https://www.sec.gov/files/rules/final/2023/33-11216.pdf

3 For the full text of the DOJ's guidelines, please see:
https://www.justice.gov/opa/media/1328226/dl?inline

4 For the full text of our client advisory on this topic, please see:
https://www.clm.com/new-13d-13g-rules-explained-elon-musk-hypothetical-section-16-update/
For the full text of the SEC rule, please see:
https://www.sec.gov/files/rules/final/2023/33-11253.pdf

5 For the full text of our client advisory on this topic, please see:
https://www.clm.com/the-corporate-transparency-act-new-beneficial-ownership-reporting-requirements/

6 For the full text of the thresholds for Section 8 of the Clayton Act, please see:
https://www.govinfo.gov/content/pkg/FR-2023-01-20/pdf/2023-00996.pdf

7 For the full text of the law, please see: https://www.congress.gov/bill/118th-congress/senate-bill/2347/text

8 The full text of the release can be found at https://www.sec.gov/rules/final/2023/34-96930.pdf

9 For the full text of client advisory on this topic, please see:
Making Waves Across the Crypto Industry: SEC v. Ripple | Carter Ledyard & Milburn LLP (clm.com)

***

related professionals

Guy P. Lander / Partner
D 212-238-8619
lander@clm.com

Claudia Carbone / Associate
D 212.238.8688
carbone@clm.com

Louie A. Ayash / Associate
D 212-238-8606
ayash@clm.com

Guy Ben-Ami / Partner
D 212-238-8658
benami@clm.com

Jennifer "Jenny" Frank / Associate
D 212-238-8650
frank@clm.com

Chenyi Wang / Associate
D 212-238-8604
wang@clm.com

Andris J. Vizbaras / Partner
D 212-238-8698
vizbaras@clm.com

Steven J. Glusband / Partner
D 212-238-8605
glusband@clm.com

Paul J. Brown, III / Associate
D 212-238-8723
pbrown@clm.com

James Gadsden / Partner
D 212-238-8607
gadsden@clm.com

Ronald M. Feiman / Partner
D 212-238-8880
feiman@clm.com