SEC/SRO UPDATE: SEC CHARGES LORDSTOWN MOTORS WITH MISLEADING DISCLOSURES; DELAWARE COURT CALLS COMMON MERGER PRACTICES INTO QUESTION; SEC UPDATES ETHICS RULES GOVERNING SECURITIES TRADING BY AGENCY PERSONNEL; SEC ADOPTS AMENDMENTS TO FORM PF

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SEC Charges Lordstown Motors with Misleading Disclosures

On February 29, 2024, the SEC charged electric vehicle maker Lordstown Motors Corp. with violations of U.S. federal securities laws in connection with alleged false disclosures about Lordstown's pickup truck model, the Endurance.[1] In a related proceeding, the SEC also charged Lordstown's former audit firm, Clark Schaefer Hackett and Co. ("CSH") with violations of the SEC's auditor independence standards.

According to the facts set forth in the SEC's order,[2] Lordstown was founded by CEO Steve Burns in 2019 to develop and manufacture electric pickup trucks for the commercial market. The company went public via a de-SPAC merger in October 2020, raising $675 million in proceeds from the transaction, including a related PIPE offering.

In connection with the merger, Lordstown claimed that it had secured 27,000 "pre-orders" from fleet customers for the Endurance, representing $1.4 billion in potential revenue. The company also claimed that its relationship with General Motors would give it access to certain parts necessary to develop the Endurance in a timely manner and at an attractive cost. It projected that it would be able to begin deliveries of the Endurance in 2021 and that it would generate $5.3 billion in revenue by the end of 2023.

According to the SEC, these claims were misleading. The "pre-orders" were based on non-binding letters of intent that did not require payment from the potential customer and did not impose any obligation to purchase. Although Lordstown disclosed the non-binding nature of the letters of intent, it did not have any procedures for evaluating the viability of pre-order customers or for tracking pre-order data. As a result, some pre-orders were from entities who appeared unable to purchase the number of trucks indicated or were not, as the company had claimed, from commercial fleets. Nevertheless, the number of disclosed pre-orders grew, reaching 100,000 in March 2021. After a short seller published a report questioning these claims, the company created a special committee to investigate; the committee found that many of the pre-orders, and at one point 71% of them, were not from fleet customers, but instead from intermediaries or influencers who did not intend to buy the trucks for their own use.

Further, the SEC said, Lordstown's statements

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about having access to General Motors parts were misleading because Lordstown failed to make clear that for many parts this access would be obtained only after a lengthy and complex process that could be unsuccessful. Ultimately, Lordstown's capital expenditures were more than double its estimates because it was forced to find parts from other sources. Further, the company repeatedly stated that delivery of trucks would begin in September 2021 when the parts issues clearly made that timing impossible. In part because of these issues, Lordstown proved unable to manufacture and sell significant numbers of Endurance trucks and it declared bankruptcy in June 2023.

In a related proceeding, the SEC charged CSH with violations of SEC and Public Company Accounting Oversight Board ("PCAOB") rules.[3] According to the SEC, while Lordstown was a private company, CSH audited the company's 2019 financial statements under Generally Accepted Accounting Standards while also helping management prepare the financial statements and providing bookkeeping services. Later, in connection with the de-SPAC merger, CSH audited the same financial statements under PCAOB standards. However, strict auditor independence rules apply under PCAOB standards pursuant to which, among other things, an auditor is not independent if it provides bookkeeping services or if helps to prepare the financial statements it audits. Accordingly, CSH violated those rules when it provided its purportedly PCAOB-compliant audit report on the 2019 financial statements.

Without admitting or denying the SEC's findings, both Lordstown and CSH agreed to a cease-and-desist order and certain monetary penalties.

Delaware Court Calls Common Merger Practices into Question

On February 29, 2024, the Delaware Chancery Court ruled on the defendants' motion to dismiss in *Sjunde AP-fonden v. Activision Blizzard, Inc.*[4] The case relates to Microsoft Corporation's acquisition of video game-maker Activision Blizzard, Inc. in 2022. The decision is noteworthy in that it suggests some that customary practices public companies use when obtaining board and stockholder approval of mergers fall short of what the Delaware General Corporation Law (the "DGCL") requires.

Microsoft approached Activision in late 2021 regarding a potential merger and on December 20, 2021, the parties agreed on a price. On January 17, 2022, the Activision board met to approve the merger. In advance of the meeting, the board received the then-current draft of the merger agreement. This draft was thought to be substantially complete, but it did not include Activision's disclosure schedules or the certificate of incorporation of the surviving corporation and contained various other blank and bracketed items. In addition, the issue of what dividends Activision could pay during the pendency of the merger remained open at the time of the board meeting. At the meeting, the board purported to approve the agreement while delegating to a special committee the authority to resolve the dividend issue through further negotiations with Microsoft. The parties executed the merger agreement the following day.

Activision filed a proxy statement to seek stockholder approval of the merger in March 2022. The proxy statement included the full text of the merger agreement but did not include the disclosure schedules or the certificate of incorporation of the

surviving corporation. Stockholders overwhelmingly approved the merger in April 2022.

In November 2022, the plaintiff, an Activision stockholder, filed suit against the Activision board and others claiming, among other things, that the merger had not been properly approved. The plaintiff argued that Section 251(b) of the DGCL requires a merging company's board of directors to approve an "execution version" of the merger agreement—*i.e.*, one with no blanks, brackets or other missing items. Defendants countered that it is customary for a board to approve an advanced or near-final draft of the merger agreement, and that insistence on having an execution version would create undesirable levels of uncertainty. The court did not resolve this issue fully, but held that at a minimum Section 251(b) requires board approval of an "essentially complete" version of the merger agreement. The court reasoned that if a board can approve a merger agreement that is not essentially complete, the approval requirement of Section 251(b) would be largely meaningless. Applying this standard, the court held that the plaintiff had adequately alleged that the merger agreement approved by the Activision board was not essentially complete in that it omitted the consideration to be received, the certificate of incorporation of the surviving corporation and a resolution of the dividend issue. Accordingly, the court denied the defendants' motion to dismiss on this point.

The court also refused to dismiss the plaintiff's allegation that the defendants had further violated DGCL Section 251 by failing to include a copy of the merger agreement with the notice to stockholders of the special meeting at which the merger was approved. Although Activision included a copy of the merger agreement in its proxy statement, the court held that this was inadequate in that the copy did not include the certificate of incorporation of the surviving corporation as required by the statute.

Parties to a merger governed by Delaware law will need to pay careful attention to this decision and the precise wording of DGCL 251. The court made clear that adherence to statutory formalities is critical to a properly approved merger even if customary market practice would suggest otherwise.

SEC Updates Ethics Rules Governing Securities Trading by Agency Personnel

On February 22, 2024, the SEC adopted amendments to its ethics rules in an effort to "strengthen and modernize its ethics compliance program."[5] The amendments amend the existing Supplemental Standards for Ethical Conduct for Members and Employees of the Securities and Exchange Commission (the "Supplemental Standards") jointly issued by the SEC and the Offices of Governmental Ethics and supplements the Standards of Ethical Conduct for Employees of the Executive Branch.

Currently, employees are prohibited from purchasing or owning securities or financial interest in entities directly regulated by the SEC (for example, registered broker-dealers and investment advisers). Under the amended Supplemental Standards, SEC expanded the scope of entities directly regulated by the SEC, and will prohibit employees from owning investment funds with a stated policy of concentrating their investments in entities directly regulated by the SEC.[6]

Under the existing Supplemental Standards, SEC employees are required to pre-clear securities transactions and report transactions within five business days after the employee receives confirmation of the transactions. This requirement applies to securities not explicitly exempted, includ-

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ing diversified mutual funds and other diversified products that pose little to no conflicts of interest such as diversified registered investment funds, money market funds, 529 plans, and diversified pooled investment funds held in employee benefit or pension plans ("Permissible Diversified Investment Funds").[7] Noting the SEC's belief that eliminating pre-clearance and reporting requirements for Permissible Diversified Investment Funds will not lead to a "reasonable perception of a decrease in ethical accountability for SEC employees,"[8] the amendments to the Supplemental Standards revise the rules to reduce the emphasis on reporting and pre-clearing Permissible Diversified Investment Funds.

SEC employees and members are required to report their securities transactions to the SEC within five business days. The proposed amendments to the Supplemental Standards would have automated the reporting process such that covered securities transactions and holdings data would have been collected directly from financial institutions through a third party automated electronic system. Due to comments received regarding cybersecurity and privacy concerns, the SEC determined to not adopt a proposal making mandatory the use of a third-party automated system, and instead authorized the use of an internal or third-party compliance system.[9]

SEC members and employees are prohibited from buying a security in an initial public offering ("IPO") for seven calendar days after the effective date of the IPO (excluding shares of a registered investment company or other publicly traded or available collective investment fund).[10] The SEC adopted the proposal to amend the Supplemental Standards to also prohibit purchases of securities that are directly listed to an exchange for seven calendar days after the direct listing effective date.[11]

The final rule became effective on March 29, 2024.

SEC Adopts Amendments to Form PF

On February 8, 2024, the SEC and the Commodities Futures Trading Commission (the "CFTC") jointly adopted amendments to Form PF, used by certain investment advisers to private funds, including investment advisers that are registered with the CFTC as commodity pool operators ("CPOs") or commodity trading advisers ("CTAs"), to report confidential information regarding the private funds they advise. According to the final rule's adopting release, the amendments "are designed to enhance the Financial Stability Oversight Council's ("FSOC's") ability to monitor systemic risk as well as bolster the SEC's regulatory oversight of private fund advisers and investor protection efforts."[12]

The amendments to Form PF (the "Form Amendments") require separate reporting for each component of master-feeder arrangements and parallel fund structures (other than feeder funds that invest all of its assets in a master fund, U.S. Treasury bills, and/or cash and cash equivalents).[13] Advisers will also be required to include the value of investments in other private funds when determining whether: i) the adviser is required to file Form PF; (ii) the adviser meets the thresholds for reporting as a large hedge fund adviser, large liquidity fund adviser, or large private equity fund adviser; (iii) a hedge fund is a qualifying hedge fund, as opposed to permitting an adviser to either include or exclude the value of other investments for determining the adviser's reporting threshold.[14] In a change from the SEC's initial proposal, which contemplated permitting advisers to report fully

owned trading vehicles on an aggregated or disaggregated basis and requiring advisers to report partially owned trading vehicles on a disaggregated basis, the final rule includes that advisers will be required to identify trading vehicles in Section 1b of Form PF and report on an aggregated basis for the reporting fund and all trading vehicles.[15] In addition, the final rule adds an instruction for advisers to specify whether the reporting fund holds assets, incurs leverage, or conducts trading or other activities through a trading vehicle.

Additionally, the Form Amendments amend Sections 1a and 1b of Form PF (applicable to all filers) to require filers to provide "additional identifying information" about the adviser and its related persons and their private fund assets under management.[16] Filers will also be required to provide additional identifying information about the private funds they manage and certain other information about such funds, including the fund's assets, financing, investor concentration, and performance.

The Form Amendments also amend Section 1c of Form PF (applicable to private fund advisers to hedge funds).[17] Advisers will be required to report the fund's use of digital assets as an investment strategy. With respect to Sections 2a and 2b of the Form, the Form Amendments remove aggregate reporting questions for large hedge fund advisers and require large hedge fund advisers to report information about the reporting fund's investment exposure, open and large position reporting, borrowing and counterparty exposure, and market factor effects.

The effective date and compliance date for the Form Amendments is March 12, 2025.

ENDNOTES:

[1] *See* www.sec.gov/news/press-release/2024-29.

[2] *See* www.sec.gov/files/litigation/admin/2024/33-11274.pdf.

[3] *See* www.sec.gov/files/litigation/admin/2024/34-99638.pdf.

[4] C.A. No. 2022-1001-KSJM, Del. Ch. (Feb. 29, 2024), *available at https://courts.delaware.gov/Opinions/Download.aspx?id=360730*.

[5] *See* https://www.sec.gov/news/press-release/2024-25.

[6] *See* https://www.sec.gov/files/rules/final/2024/34-99582.pdf at pg. 3.

[7] *See* https://www.sec.gov/files/rules/final/2024/34-99582.pdf at pg. 11.

[8] *See* https://www.sec.gov/files/rules/final/2024/34-99582.pdf at pg. 13.

[9] *See* https://www.sec.gov/files/rules/final/2024/34-99582.pdf at pg. 21.

[10] *See* https://www.sec.gov/files/rules/final/2024/34-99582.pdf at pg. 29.

[11] *See https://www.sec.gov/files/rules/final/2024/34-99582.pdf at pg. 29-30.*

[12] *See* https://www.sec.gov/files/rules/final/2024/ia-6546.pdf at pg. 1.

[13] *See* https://www.sec.gov/files/rules/final/2024/ia-6546.pdf at pg. 7.

[14] *See* https://www.sec.gov/files/rules/final/2024/ia-6546.pdf at pg. 8.

[15] *See* https://www.sec.gov/files/rules/final/2024/ia-6546.pdf at pg. 8.

[16] *See* https://www.sec.gov/files/rules/final/2024/ia-6546.pdf at pg. 9.

[17] *See* https://www.sec.gov/files/rules/final/2024/ia-6546.pdf at pg. 9-10.

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