

Client Alert

SEC Adopts Amendments to MD&A and Financial Disclosures



December 1, 2020

On November 19, 2020, the Securities and Exchange Commission (SEC) adopted amendments to Regulation S-K to modernize, simplify and enhance certain financial disclosure requirements in the Management's Discussion and Analysis of Financial Condition and Results of Operations (MD&A) section of applicable SEC filings, including Form 10-Ks, Form 10-Qs and registration statements on Form S-1. As part of these amendments, the SEC removed a number of prescriptive items required by Regulation S-K and replaced those items with a more principles-based framework for MD&A disclosures. The adopting release is available [here](#).

Companies will be required to comply with the amended rules for their first fiscal year ending on or after 210 days after publication in the Federal Register, which is referred to as the "mandatory compliance date." As a result, calendar year-end companies will need to start complying with the amended rules for their annual reports on Form 10-K for the year ending December 31, 2021. Companies will be required to apply the amended rules in a registration statement and prospectus that on its initial filing date is required to contain financial statements for a period on or after the mandatory compliance date. Companies may voluntarily elect to provide disclosure consistent with the final rules any time after the effective date (which is 30 days after publication in the Federal Register), so long as they provide disclosure responsive to an amended item in its entirety and provide such disclosure in all applicable filings going forward.

The amendments were adopted by the SEC by a vote of 3-2, with Commissioners Lee and Crenshaw dissenting. The dissenting Commissioners, in a [joint statement](#), noted their objection to two significant aspects of the rule. First, they noted that the final rule eliminates the contractual obligations table that they believe "currently provides investors with critical insight into supply chain and risk management." Second, they noted that the amendments fail "completely to address climate risk." In their statement, the dissenting Commissioners urge the SEC to engage in new rulemaking specific to climate, human capital and other ESG risks going forward. While acknowledging that some commenters had provided input addressing whether there is a need for additional disclosure requirements related to ESG and sustainability matters, the final amendments adopted by the SEC did not add any new requirements for MD&A disclosures with respect to ESG or sustainability matters, noting the SEC's principles-based approach to MD&A and the SEC's existing interpretive guidance regarding disclosure related to climate change (see [Release No. 33-9106 \(February 8, 2010\)](#)).

Final Amendments

The SEC had proposed amendments on January 30, 2020 as part of the SEC's "Disclosure Effectiveness Initiative," informed by the objectives of the Fixing America's Surface Transportation Act, which, among other things, required the SEC to study ways that Regulation S-K can be modernized and simplified. The

amendments, which were adopted substantially as proposed with certain modifications, reflect the SEC's long-standing commitment to a principles-based, registrant-specific approach to disclosure. The amendments are summarized in [Appendix A](#) to this alert (available [here](#)).

The more significant amendments to Regulation S-K include:

- eliminating *Item 301 (Selected Financial Data)*, which generally requires companies (with exceptions for smaller reporting companies and emerging growth companies) to furnish selected financial data in comparative tabular form for each of the last five fiscal years;
- streamlining *Item 302 (Supplementary Financial Information)*, which requires disclosure of selected financial data for each quarter within the two most recent fiscal years, to require disclosure only when there are one or more retrospective changes that pertain to the statements of comprehensive income for any of the quarters within the two most recent fiscal years and any subsequent interim period;
- enhancing *Item 303(a)(2)(i)* in a newly captioned *Item 303(b)(1)(ii) (Capital Resources)* to require discussion of material cash requirements of the company, including but not limited to capital expenditures (currently the requirement is to discuss material commitments for capital expenditures only);
- replacing *Item 303(a)(4) (Off-Balance Sheet Arrangements)*, which requires disclosures about off-balance sheet arrangements in a separately captioned section, with an instruction regarding the need to discuss such obligations in the broader context of MD&A;
- eliminating *Item 303(a)(5) (Contractual Obligations Table)*, which generally requires companies (other than smaller reporting companies) to disclose in tabular format their known contractual obligations by type of obligations and overall payments due, and amending *Item 303(b)* to specifically require disclosure of material cash requirements from known contractual and other obligations as part of the liquidity and capital resources discussion;
- adding a new *Item 303(b)(3)* to expressly require disclosure of critical accounting estimates and including an instruction specifying that the disclosure of critical accounting estimates should supplement, but not duplicate, the description of accounting policies in the notes to the financial statements; and
- amending *Item 303(b) (Interim Periods)* to permit companies to compare their most recently completed quarter to either the corresponding quarter of the prior year or the immediately preceding quarter.

Other amendments to Regulation S-K include: adding a new *Item 303(a)* to state the principal objectives of MD&A; amending *Item 303* to add “product lines” of the company as an example of other subdivisions that the company should discuss if appropriate to an understanding of the company’s business; clarifying that a company should discuss “*material changes*” (as opposed to only “*material increases*”) from period to period in net sales and revenues and “*underlying reasons*” (rather than only the “*cause*”) of material changes from period-to-period in one or more line items in quantitative and qualitative terms; and eliminating *Item 303(a)(iv)*, which requires companies to discuss the impact of inflation and changing prices. The SEC also made other corresponding changes, such as eliminating unnecessary cross-references to industry guides, eliminating certain instructions and making other conforming changes. Although not specifically described here or in [Appendix A](#), the final rules also include certain parallel amendments to Forms 20-F and 40-F applicable to disclosures provided by foreign private issuers.

Appendix A

Summary of SEC Amendments¹

<u>Regulation S-K</u>		
<u>Topic</u>	<u>Rule(s) Impacted</u>	<u>Summary of Change / Amendment</u>
Selected Financial Data	Item 301	<p>Eliminates the requirement for registrants (for whom the disclosure requirement applies) to furnish selected financial data in comparative tabular form for each of the last five fiscal years (or for the life of the registrant, if less) and any additional fiscal years necessary to keep the information from being misleading.</p> <p>In the adopting release, the SEC noted that, notwithstanding the amendments to eliminate Item 301, it encourages registrants to consider whether trend information for periods earlier than those presented in the financial statements may be necessary as part of MD&A's objective to "provide material information relevant to an assessment of the financial condition and results of operations." Citing to its <i>Commission Guidance Regarding Management's Discussion and Analysis of Financial Condition and Results of Operations</i>, Release No. 33-8350 (Dec. 29, 2003), the SEC also encourages registrants to consider whether a tabular presentation of relevant financial or other information, as part of an introductory section or overview, including to demonstrate material trends, may help a reader's understanding of MD&A.</p>
Supplementary Quarterly Financial Information	Item 3022	Streamlines the requirement for registrants to disclose supplementary quarterly financial information for the two most recent fiscal years plus any subsequent interim period for which financial statements are included or

¹ Although not specifically described here, the final rules include certain parallel amendments to Forms 20-F and 40-F applicable to disclosures provided by foreign private issuers.

² The SEC had proposed eliminating Item 302(b), which requires registrants engaged in oil and gas producing activities, other than smaller reporting companies, to disclose information about those activities for each period presented, if the FASB finalizes amendments to U.S. GAAP that would make the requirements of Item 302(b) duplicative of U.S. GAAP. As the FASB has not yet finalized the amendments, the SEC is retaining Item 302(b) and may reconsider the proposal in the future.

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		<p>required to be included by Article 3 of Regulation S-X to only when there are one or more retrospective changes that pertain to the statements of comprehensive income for any of the quarters within such two-year or subsequent interim period and that, individually or in the aggregate, are material.</p> <p>Examples of a retrospective change that may trigger disclosure include: a correction of an error; disposition of a business that is accounted for as discontinued operations; a reorganization of entities under common control; or a change in an accounting principle. The SEC cautions that these examples are not intended to be an exhaustive list and may not always be material such that disclosure would be required.</p> <p>The amendments require registrants to provide an explanation of the reasons for such material changes and to disclose, for each affected quarterly period and the fourth quarter in the affected year, summarized financial information related to the statements of comprehensive income (as specified in Rule 1-02(bb)(ii) of Regulation S-X) and earnings per share reflecting such changes. The SEC also adopted amendments to Rule 1-02(bb) to clarify that the disclosure of summary financial information may vary, as appropriate, to conform to the nature of the entity's business.</p> <p>In a change from the current Item 302(a), the amended rule will apply beginning with the first filing on Form 10-K after the registrant's initial registration of securities under Sections 12(b) or 12(g) of the Securities Exchange Act of 1934. When a new registrant has a material</p>

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		<p>retrospective change to its year-to-date interim period information in its most recent registration statement but has not yet disclosed that interim period information in quarterly increments, the SEC notes that it would not object if the disclosures are presented for the affected year-to-date interim period and the fourth quarter in the affected year.</p> <p>Consistent with current Item 302, first time registrants conducting an IPO, registrants that are only required to file reports pursuant to Section 15(d) and smaller reporting companies are not required to comply with the amended Item 302(a) disclosure requirements.</p>
MD&A - Objective	New Item 303(a)	<p>Adds a new Item 303(a) to describe the objectives of MD&A that:</p> <ul style="list-style-type: none"> • Incorporates the following portions of current Instructions 1, 2 and 3, to require companies to disclose: <ul style="list-style-type: none"> ○ Material information relevant to an assessment of the financial condition and results of operations of the registrant, including an evaluation of the amounts and certainty of cash flows from operations and from outside sources. ○ Material events and uncertainties known to management that are reasonably likely to cause reported financial information not to be indicative of future operating results or of future financial condition. This includes descriptions and amounts of matters that have had a material impact on reported operations as well as matters that are reasonably likely based on management's assessment

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		<p>to have a material impact on future operations.</p> <ul style="list-style-type: none"> ○ The material financial and statistical data that the registrant believes will enhance a reader's understanding of the registrant's financial condition, cash flows and other changes in financial condition and results of operations. • Incorporates the SEC's guidance that MD&A is intended to provide disclosures from "<i>management's perspective.</i>" <p>In the adopting release, the SEC reminds registrants that they should regularly revisit these objectives as they prepare their MD&A and consider ways to enhance the quality of the analysis provided and notes that these amendments are intended to remind registrants that MD&A should provide an analysis that encompasses short-term results as well as future prospects.</p>
MD&A - Full Fiscal Years	Re-captioned current Item 303(a) as Item 303(b)	Moves to new Item 303(b) the portion of current Instruction 4 to Item 303(a) that requires a description of the causes of material changes from year-to-year in line items of the financial statements, and clarifies that such description requires a narrative discussion of the " <i>underlying reasons</i> " for material changes from period-to-period in one or more line items in quantitative and qualitative terms, rather than only the " <i>cause</i> " for material changes. In addition, the amendment clarifies that registrants should discuss material changes within a line item even when such material changes offset each other. In the adopting release, the SEC acknowledges that isolating reasons for specific material changes, and quantifying

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		<p>such isolated reasons, can sometimes be challenging because they are highly interrelated. In such circumstances, the SEC encourages registrants to acknowledge this fact and to explain such interrelated circumstances to the extent possible.</p> <p>Adds “<i>product lines</i>” as an example of other subdivisions of a registrant’s business that should be discussed in the MD&A if, in the registrant’s judgment, it is necessary to an understanding of the registrant’s business. Current relevant Item 303(a) language states that where, in the registrant’s judgment, a discussion of segment information and/or of other <i>subdivisions</i> (e.g., geographic areas) of the registrant’s business would be necessary to an understanding of such business, the discussion shall focus on each reportable segment and/or other subdivision of the business and on the registrant as a whole.</p>
MD&A - Liquidity and Capital Resources	Item 303(a)(2) (New Item 303(b)(1) and Amended (and re-captioned) Item 303(b)(1)(ii))	<p>Revised Item 303(b)(1) provides the overarching requirements for liquidity and capital resources disclosures in order to clarify the principles-based liquidity and capital resources requirements. The amendments require registrants to discuss liquidity and capital resource requirements on both a short-term (up to 12 months) and long-term (beyond 12 months) basis, including those from contractual and other obligations. The specific disclosure requirements for liquidity and capital resources are included in re-captioned Items 303(b)(1)(i) and 303(b)(1)(ii).</p> <p>Current Item 303(a)(1) is re-captioned as Item 303(b)(1)(i) with no changes. Accordingly, registrants must continue to disclose any known trends or known demands, commitments, events or uncertainties that will</p>

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		<p>result in or are reasonably likely to result in the registrant's liquidity increasing or decreasing in a material way (as well as the course of action to remedy the deficiency). Registrants must also continue to describe internal and external sources of liquidity and briefly discuss any material unused sources of liquidity.</p> <p>Item 303(b)(1)(ii) re-captions and amends current Item 303(a)(2)(i) by specifying that a registrant should describe its material cash requirements, including commitments for capital expenditures, as of the end of the latest fiscal period, the anticipated source of funds needed to satisfy such cash requirements and the general purpose of such requirements. Under current Item 303(a)(2)(i), registrants must only provide a description of the registrant's material commitments for capital expenditures. The SEC noted that while capital expenditures remain important in many industries, certain expenditures and cash commitments that are not necessarily capital investments in property, plant and equipment may be increasingly important to companies, especially those for which human capital or intellectual property are key resources.</p> <p>The requirements of current Item 303(a)(2)(ii), which require a description of any known material trends, favorable or unfavorable, in the registrant's capital resources (indicating any expected material changes in the mix and relative cost of such resources), will continue to apply under a re-captioned section of Item 303(b)(1)(ii).</p>

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MD&A - Results of Operations - Known Trends or Uncertainties	Item 303(a)(3)(ii) and Amended (and re-captioned) Item 303(b)(2)(ii)	<p>Current Item 303(a)(3)(ii) requires a registrant to describe any known trends or uncertainties that have had or that the registrant reasonably expects <i>will</i> have a material impact (favorable or unfavorable) on net sales or revenues or income from continuing operations. In addition, if the registrant knows of events that <i>will</i> cause a material change in the relationship between costs and revenues (such as known future increases in costs of labor or materials or price increases or inventory adjustments), the change in the relationship must be disclosed.</p> <p>Amends the current disclosure requirement to provide that when a registrant knows of events that are “<i>reasonably likely</i>” to cause (as opposed to <i>will</i> cause) the material impact or material change referenced above, the reasonably likely change must be disclosed.</p> <p>In the adopting release, the SEC notes that when considering whether disclosure of a known event or uncertainty is required, the analysis is based on materiality and what could be considered important by a reasonable investor in making a voting or investment decision. The “reasonably likely” threshold does not require disclosure of any event that is known but for which fruition may be remote, nor does it set a bright-line percentage threshold by which disclosure is triggered. Rather, as the SEC notes, this threshold requires a “thoughtful analysis that applies an objective assessment of the likelihood that an event will occur balanced with a materiality analysis regarding the need for disclosure regarding such event.” Known trends, demands, commitments, events or uncertainties that are not remote or where management cannot make an assessment as to the likelihood that they will come to fruition,</p>

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		and that would be reasonably likely to have a material effect on the registrant's future results or financial condition, were they to come to fruition, should be disclosed if a reasonable investor would consider omission of the information as significantly altering the mix of information made available in the registrant's disclosures.
MD&A - Results of Operations - Net Sales and Revenues	Item 303(a)(3)(iii) and Amended (and re-captioned) Item 303(b)(2)(iii)	<p>Current Item 303(a)(3)(iii) specifies that, to the extent financial statements disclose <i>material increases</i> in net sales or revenues, a registrant must provide a narrative discussion of the extent to which such increases are attributable to increases in prices, to increases in the volume or amount of goods or services being sold or to the introduction of new products or services.</p> <p>Amends the current disclosure requirement to tie the required disclosure to "<i>material changes</i>" in net sales or revenues, rather than solely to "<i>material increases</i>," to codify the SEC's prior guidance that the results of operations discussion should describe not only increases but also decreases in net sales or revenues.</p>
MD&A - Results of Operations - Inflation and Price Changes	Item 303(a)(3)(iv) and Instructions 8 and 9 to Item 303(a)	<p>Eliminates the requirement for registrants to discuss the impact of inflation and price changes on their net sales, revenue and income from continuing operations.</p> <p>The SEC notes that under amended Item 303, registrants will be required to discuss the impact of inflation or changing prices if they are part of a known trend or uncertainty that had, or is reasonably likely to have, a material impact on net sales, revenue or income from continuing operations. In addition, amended</p>

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		(and re-captioned) Item 303(b) requires that registrants describe the “underlying reasons” for material changes in quantitative and qualitative terms in one or more line items, which may also implicate a discussion of inflation and changing prices.
MD&A - Off-Balance Sheet Arrangements	Item 303(a)(4) (New Instruction 8 to re-captioned Item 303(b))	<p>Replaces current Item 303(a)(4), which requires disclosures about off-balance sheet arrangements in a separately captioned section with a new principles-based Instruction 8 to Item 303(b) that requires registrants to discuss off-balance sheet arrangements “that have, or are reasonably likely to have, a material current or future effect on a registrant’s financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, cash requirements, or capital resources” within the context of broader MD&A disclosures.</p> <p>As the discussion would no longer occur in a separately-captioned section, the SEC expects that a registrant will incorporate its discussion of off-balance sheet arrangements into its broader discussion of liquidity and capital resources. The SEC notes, however, that to the extent a registrant determines that some discussion of off-balance sheet arrangements should be highlighted separately or in a separately-captioned section in order to facilitate an understanding of such disclosure, or to highlight particularly material information about such arrangements, it has the discretion to do so.</p>
MD&A - Contractual Obligations Table	Item 303(a)(5) and Amended (and re-captioned) Item 303(b)(1)	Eliminates the requirement in current Item 303(a)(5) to disclose a table of the registrant’s known contractual obligations over specified periods as of the latest fiscal year end balance sheet date. In lieu of the contractual

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		<p>obligations table, the liquidity and capital resources discussion required by amended (and re-captioned) Item 303(b)(1) summarized above specifically requires disclosure of material cash requirements from known contractual and other obligations, including disclosure of the type of obligation and the relevant time period for the related cash requirements. New Instruction 4 to Item 303(b) also states that the discussion of material cash requirements from known contractual obligations may include, for example, lease obligations, purchase obligations or other liabilities reflected on the registrant's balance sheet.</p> <p>In adopting the change, the SEC noted that the amendments are intended to improve the transparency of a registrant's short- and long-term liquidity and capital resources needs and demands while reducing undue burdens to prepare such disclosure. The SEC believes the amendments allow registrants flexibility in discussing material cash requirements from known contractual and other obligations as they do not prescribe specific categories of contractual obligations unlike current Item 303(a)(5).</p>
MD&A - Critical Accounting Estimates	New Item 303(b)(3)	<p>Consistent with prior SEC guidance and customary disclosure practices, new Item 303(b)(3) will explicitly require registrants to provide disclosure regarding their critical accounting estimates. The amendments define critical accounting estimates as "estimates made in accordance with generally accepted accounting principles that involve a significant level of estimation uncertainty and have had or are reasonably likely to have a material impact on the registrant's financial condition or results of operations." To eliminate duplicative financial statements</p>

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		<p>footnote disclosures about significant accounting policies, a sentence added to new Instruction 3 to Item 303(b) provides that the disclosure shall supplement, but not duplicate, the description of accounting policies or other disclosures in the notes to the financial statements.</p> <p>The item requires registrants to provide qualitative and quantitative information necessary to understand the estimation uncertainty and the impact the critical accounting estimate has had, or is reasonably likely to have, on financial condition or results of operations to the extent the information is material and reasonably available. For each critical accounting estimate, the amendments require registrants to disclose why the estimate is subject to uncertainty and, to the extent information is material and reasonably available, how much each estimate and/or assumption has changed during the relevant period and the sensitivity of the reported amounts to the methods, assumptions and estimates underlying the estimate's calculation.</p>
MD&A - Interim Period Discussion	Item 303(b) and Amended (and re-captioned) Item 303(c)	Amended Item 303(c)(2)(ii) permits registrants to compare their most recently completed quarter to either the corresponding quarter of the prior year (as is currently required) or to the immediately preceding quarter. If a registrant elects to discuss changes from the immediately preceding sequential quarter, the registrant must provide summary financial information that is the subject of the discussion for that quarter or identify the prior EDGAR filing that presents such information so that a reader may have ready access to the prior quarter financial information being discussed. In addition, if a registrant changes the comparison from the prior interim period

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		<p>comparison, the registrant would be required to explain the reason for the change and present both comparisons in the filing where the change is announced.</p> <p>In adopting this change, the SEC recognizes that not all businesses are seasonal and a comparison to the corresponding quarter of the preceding year may not be as meaningful as a comparison to the preceding quarter. The SEC believes the flexibility provided by the amendments will help registrants provide a more tailored and meaningful analysis that is relevant to their specific business cycles while also providing investors with material information to assess quarterly performance.</p> <p>However, amended Item 303(c)(2)(i) will continue to require registrants to discuss any material changes in their results of operations between the most recent year-to-date interim period(s) and the corresponding period(s) of the preceding fiscal year. The SEC believes this comparative year-to-date disclosure complements the MD&A provided in annual reports and provides important context for the current quarter.</p>
MD&A - Safe Harbor for Forward-Looking Information	Item 303(c)	Eliminates current Item 303(c), which provides that the safe harbors provided in Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934 apply to all forward-looking information provided in response to Item 303(a)(4) (off-balance sheet arrangements) and Item 303(a)(5) (contractual obligations), provided such disclosure is made by certain enumerated persons.

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		<p>The SEC notes that the amendments are intended to be conforming changes since the SEC is eliminating both Items 303(a)(4) and (5) but that elimination of current Item 303(c) is not intended to alter the availability of the above-referenced statutory safe harbor provisions of the Private Securities Litigation Reform Act or the regulatory safe harbors in Securities Act Rule 175 and Exchange Act Rule 3b-6, which expressly apply to forward-looking information in MD&A disclosure. The SEC reminds registrants of the availability and scope of these safe harbors and encourages greater disclosure of forward-looking information.</p>
MD&A - Smaller Reporting Companies	Item 303(d)	<p>Eliminates Item 303(d), which provided accommodations to smaller reporting companies with respect to the disclosure required by Item 303(a)(3)(iv) (regarding the impact of inflation and changing prices) and excluded smaller reporting companies from the requirement to provide the contractual obligations table specified in Item 303(a)(5). In light of the elimination of Items 303(a)(3)(iv) and (a)(5) as part of the SEC's amendments, these instructions were no longer applicable.</p> <p>The SEC clarified, however, that, notwithstanding the elimination of current Item 303(a)(5), new Item 303(b) requires disclosure of any material cash requirements from known contractual and other obligations, and smaller reporting companies are required to provide this disclosure under the amended requirements as such disclosure may be necessary to an understanding of the registrant's financial condition, cash flows and other changes in financial conditions and results of operations.</p>

This memorandum is a summary for general information and discussion only and may be considered an advertisement for certain purposes. It is not a full analysis of the matters presented, may not be relied upon as legal advice, and does not purport to represent the views of our clients or the Firm. John-Paul Motley, an O'Melveny Partner licensed to practice law in California, Shelly Heyduk, an O'Melveny Partner licensed to practice law in California, Robert Plesnarski, an O'Melveny Partner licensed to practice law in the District of Columbia and Pennsylvania, and Su Lian Lu, an O'Melveny Senior Counsel licensed to practice law in California and New York, contributed to the content of this newsletter. The views expressed in this newsletter are the views of the authors except as otherwise noted.

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