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# Q3 2021 U.S. Legal & Regulatory Developments

The following is our summary of significant U.S. legal and regulatory developments during the third quarter of 2021 of interest to Canadian companies and their advisors.

## 1. SEC Approves Nasdaq Board Diversity Requirements

On Friday, August 6, 2021, the Securities and Exchange Commission ("SEC") approved Nasdaq's board diversity requirements. As a result, each Nasdaq-listed company will be required to disclose the self-identified diversity characteristics of its board members beginning on the later of August 8, 2022 or the date of the company's proxy/information statement for its 2022 annual meeting. By 2023, listed companies will be required to have at least one director who self-identifies as diverse or to explain why the company does not meet this requirement. By 2025, each company listed on the Nasdaq Global Select or Global Markets will be required to have at least two directors who self-identify as diverse, including at least one director who self-identifies as female and at least one director who self-identifies as an underrepresented minority, or to explain why the company does not meet such requirements.

These listing requirements also apply to smaller-reporting companies and non-U.S. issuers (including foreign private issuers). Companies with small boards (five or fewer directors) will be able to meet the board diversity requirements by having one director who self-identifies as diverse. Foreign issuers may use a different disclosure matrix, provide and use an alternate definition of "underrepresented minority" based on the relevant national, racial, ethnic, indigenous, cultural, religious or linguistic identities in the jurisdiction of their principal executive offices, and satisfy the board diversity requirement by having two directors who self-identify as female. If foreign issuers elect to follow alternative diversity requirements in accordance with home country practices, or are located in jurisdictions that restrict the collection of personal data, they may satisfy the listing requirements by explaining their reasons for doing so.

If a company fails to provide the required diversity disclosures, Nasdaq will notify the company of its noncompliance. Companies will have 45 days to submit a plan to Nasdaq, and 180 days to regain compliance. If a company then fails to regain compliance, Nasdaq will issue a Staff Delisting Determination. The diversity requirements include a grace period for board vacancies.

For the full text of our memorandum, please see:

- https://www.paulweiss.com/media/3981309/sec_approves_nasdaq_board_diversity_requirements.pdf

For the Nasdaq proposal adopted by the SEC, please see:

- https://listingcenter.nasdaq.com/assets/RuleBook/Nasdaq/filings/SR-NASDAQ-2020-081_Amendment_1.pdf

For Nasdaq's guidance on the implementation of these rules, please see:

- https://listingcenter.nasdaq.com/assets/Board%20Diversity%20Disclosure%20Five%20Things.pdf

## 2. SEC Initiates First Enforcement Proceeding of the SPAC Boom Against SPAC, Sponsor, Merger Target and CEOs

On July 13, 2021, the SEC charged a special purpose acquisition company ("SPAC"), its sponsor, its proposed merger target and both the SPAC's and target's CEOs with making false and misleading statements about the target company's technology and ability to obtain essential licenses. The charges represent the SEC's first enforcement action against a SPAC since the "SPAC boom" took off late last year.

Stable Road Acquisition Corp., a SPAC, completed its initial public offering in November 2019. The SPAC's CEO was also a managing member of the SPAC's sponsor. On October 7, 2020, the SPAC announced a merger with Momentus, Inc. ("Momentus"), an early-stage space transportation company. On the same day, the SPAC raised $175 million of capital by entering into subscription agreements with private investment in public equity ("PIPE") investors in exchange for shares in the merged company after the business combination was approved.

Before the proposed business combination closed, the SEC charged Momentus and its CEO with scienter-based fraud under Section 17(a) of the Securities Act of 1933 (the "Securities Act") and Section 10(b) of the Securities Exchange Act of 1934 (the "Exchange Act") and Rule 10b-5 thereunder. The SEC alleged that Momentus falsely claimed that its propulsion technology had been successfully tested in space, and that Momentus misled investors by downplaying known national security concerns about its CEO.

The SEC also charged the SPAC, its sponsor, and its CEO with violations under Section 17(a)(2) and (3) of the Securities Act and Sections 13(a) and 14(a) of the Exchange Act, alleging principally that the SPAC issued misleading disclosures because it "did not perform reasonable due diligence" on the target. The SPAC retained a space technology consulting firm to investigate the target only one month before the merger announcement, and did not instruct the firm to investigate the target's space tests. Accordingly, the SEC alleged that the SPAC's investor presentations and public filings contained materially misleading statements. The SEC further alleged that the SPAC CEO's actions were attributable to the SPAC's sponsor because he served as the sponsor's managing member and his actions were taken on behalf of and for the benefit of the sponsor.

The parties, except Momentus' CEO, settled on a "no admit, no deny" basis, with the SPAC, its CEO and Momentus agreeing to pay civil penalties. The SPAC and Momentus also agreed to offer every PIPE investor the right to terminate its subscription agreement, and the SPAC's sponsor agreed to forgo 250,000 founder shares to which it would otherwise have been entitled upon the business combination. Momentus also agreed to retain an independent consultant to review its ethics and compliance programs. Litigation is currently proceeding for Momentus' CEO.

For the full text of our memorandum, please see:

- https://www.paulweiss.com/media/3981274/sec_initiates_first_enforcement_proceeding_of_the_spac_boom_against_spac_sponsor_merger_target_and_ceos.pdf

For a copy of the SEC's order against Stable Road Acquisition Corp, its sponsor, its CEO and Momentus, please see:

- https://www.sec.gov/litigation/admin/2021/33-10955.pdf

For a copy of the SEC's complaint against Momentus' CEO in the United States District Court for the District of Columbia, please see:

- https://www.sec.gov/litigation/complaints/2021/comp-pr2021-124.pdf

## 3. SEC Division of Corporation Finance Publishes Sample Climate Disclosure Comments

On September 24, 2021, the Staff of the SEC Division of Corporation Finance issued a sample comment letter (the "Sample Comments") reflecting comments on climate disclosure that the Staff may issue when reviewing companies' public filings. The Sample Comments refer to the SEC's 2010 guidance on climate disclosures and request additional disclosure, where material, in the risk factors and MD&A sections. In addition, the Sample Comments indicate that the SEC will be reviewing the disclosures provided by companies in their social responsibility/sustainability reports and comparing those to the SEC filing disclosures. Companies that previously limited substantive climate-related disclosure to social responsibility/sustainability reports should now consider the guidance of these SEC comments when preparing their public filings.

The Sample Comments include the disclosure of certain risk factors, such as any material litigation risks related to climate change and an explanation of its potential impact on the company, as well as the disclosure of material effects of transition risks related to climate change that may affect the company's business, financial condition and results of operations.

Within MD&A sections, the Sample Comments include requests to identify material pending or existing climate change-related legislation, regulations and international accords, and describe any material effect on the business, financial condition and results of operations of the company. In addition, the Sample Comments include requests to identify and quantify material past and/or future capital expenditures for climate-related projects and to discuss the indirect consequences of climate-related regulations and business trends and the physical effects of climate change on operations and results.

The issuance of these comments reflects the SEC's increased scrutiny of climate disclosures and follows various initiatives announced earlier in 2021 by then Acting Chair Allison Herren Lee. Chair Gary Gensler has called on the SEC to develop mandatory climate disclosure requirements to provide investors with "consistent, comparable and decision-useful" disclosure, which the SEC is expected to propose this fall.

For the full text of our memorandum, please see:

- https://www.paulweiss.com/media/3981422/sec_division_of_corporation_finance_publishes_sample_climate_disclosure_comments.pdf

For the SEC's Sample Comments, please see:

- https://www.sec.gov/corpfin/sample-letter-climate-change-disclosures?utm_medium=email&utm_source=govdelivery

For the SEC's 2010 guidance on climate disclosure, please see:

- https://www.sec.gov/rules/interp/2010/33-9106.pdf

## 4. NYSE Amends Related Party Transaction Threshold Requirement

On August 19, 2021, the New York Stock Exchange ("NYSE") re-amended Rule 314.00, *Related Party Transactions*, which requires a company's audit committee to review and oversee all potential transactions involving related parties for potential conflicts of interest and to prohibit any such transaction if the audit committee determines that it is inconsistent with the interests of the company and its shareholders. The amended rule now states that related party transactions below $120,000 are exempt from these approval requirements. The NYSE had previously amended Rule 314.00 to, among other things, require approval of any transactions disclosable under Item 404 of Regulation S-K, but without applying the transaction value threshold of that provision.

This latest amendment adopts Item 404's definition of related party transactions wholesale, and aligns with Nasdaq's definition of related party transactions. The rule change took effect immediately upon filing with the SEC.

For the full text of our memorandum, please see:

- https://www.paulweiss.com/media/3981380/nyse_amends_related_party_transaction_threshold_requirement.pdf

For a copy of the rule change filing, please see:

- https://www.nyse.com/publicdocs/nyse/markets/nyse/rule-filings/filings/2021/SR-NYSE-2021-43,%20Re-file%20Pdf.pdf

## 5. Board Oversight of "Mission-Critical" Regulatory Issues

In *In re The Boeing Company Derivative Litigation*, the Delaware Court of Chancery declined to dismiss claims that the board members breached their duty of oversight by failing to establish an effective airplane safety monitoring system and follow up on related red flags after the first crash of The Boeing Company's 737 MAX airplane. Although the litigation is still pending, the opinion by Vice Chancellor Zurn reiterates the importance of board oversight of "mission-critical" regulatory issues and gives guidance as to possible board processes to fulfill their oversight duties.

To comply with these duties, the court noted that a board could identify what, if any, mission-critical compliance issues exist for the company. Once identified, the board's chosen process for handling such matters can be appropriately documented in committee charters, board or committee meeting agenda items, and board or committee meeting minutes, for example. Boards should also consider taking steps to ensure that management apprises the board of these mission-critical issues in a holistic manner and on a consistent basis. For example, the court was critical of the alleged fact that the board received no "safety-centric" updates from management and instead only received management-initiated updates focused on the company's production and revenue strategy.

Further, boards may also consider pressing management for further information without passively accepting its assurances and opinions on key compliance issues and red flags. Even where there are extensive reporting systems and controls in place, a board should ensure that red flag compliance issues are adequately reported to the board and an adequate response is implemented.

For the full text of our memorandum, please see:

- https://www.paulweiss.com/media/3981408/board_oversight_of_mission_critical_regulatory_issues.pdf

For, the Delaware Court of Chancery's opinion, please see:

- https://courts.delaware.gov/Opinions/Download.aspx?id=324120

## 6. New Lawsuits Alleging That SPACs Are Unregistered Investment Companies Face Significant Hurdles

Two law professors—one a former SEC commissioner—have opened a new litigation front against SPACs. In their complaints, they allege that three separate SPACs—including Bill Ackman's $4 billion Pershing Square Tontine Holdings, Ltd., the largest SPAC in history to date—qualify as investment companies under the Investment Company Act of 1940 (the "ICA") because the SPACs have invested in short-term government securities and money market funds for over a year. In addition, the complaints allege that the managers of the sponsors of the SPACs are investment advisers under the Investment Advisers Act of 1940 (the "IAA"). The complaints allege that the SPACs are therefore subject to the ICA and IAA's stringent requirements, including registration, and that the basic structure and compensation arrangements of the SPACs and their sponsors are in violation of the ICA and IAA.

A critical threshold issue is whether the SPACs are investment companies under the ICA, which courts do not appear to have addressed. In general, an issuer is an "investment company" under the ICA if it is "primarily engaged" in investing securities. It is a longstanding view of practitioners and the SEC that temporarily investing in treasuries and qualified money market funds does not turn an entity into an investment company. A group of over 55 leading law firms (including Paul, Weiss) issued a statement asserting that SPACs are not investment companies under the ICA.

While each SPAC may currently be invested in government securities or money market funds, their ultimate goal is to identify and complete a suitable business combination. Another hurdle is the SEC's transient investment companies rule, where an issuer is deemed not to be an investment company for up to a year if it has a bona fide intent to engage in a business other than securities investment. As such, most SPACs may be able to avoid liability if they consummate an acquisition within one year, or if they are required to liquidate the company and return funds to investors in the event that they do not complete an acquisition within a year.

For the full text of our memorandum, please see:

- https://www.paulweiss.com/media/3981370/new_lawsuits_alleging_that_spacs_are_unregistered_investment_companies_face_significant_hurdles.pdf

For a statement by over 55 leading law firms (including Paul, Weiss) asserting that SPACs are not investment companies under the ICA, please see:

- https://www.paulweiss.com/media/3981368/spac_joint_statement_8302021.pdf

For our client alert on what SPAC sponsors, directors and officers can do to mitigate their litigation exposure, please see:

- https://www.paulweiss.com/media/3980948/what_spac_sponsors_directors_and_officers_can_do_to_mitigate_their_litigation_exposure.pdf

## 7. FTC Rescinds Vertical Guidelines, Introducing Opacity Into Merger Review

On September 15, 2021, the Federal Trade Commission ("FTC") rescinded its Vertical Merger Guidelines. These guidelines were issued jointly by the Department of Justice ("DOJ") and FTC in June 2020, and served to "outline the principal analytical techniques, practices, and enforcement policies" of the DOJ and FTC for vertical mergers and acquisitions. The FTC did not issue replacement guidelines, and intends to issue updated guidelines in the future. The Vertical Merger Guidelines remain in place at the DOJ, which intends to work with the FTC and update the guidelines.

The Vertical Merger Guidelines describe ways in which a vertical merger might, in the FTC's view, have both harmful unilateral effects and harmful coordinated effects, while also setting forth certain pro-competitive benefits that vertical mergers might have, such as lowering prices by eliminating double marginalization.

The Vertical Merger Guidelines were issued to increase the transparency of FTC enforcement, and the rescinding of the guidelines and lack of any superseding guidelines introduces a degree of opacity and uncertainty to reviews of vertical mergers. However, it is unclear what practical effect, if any, the FTC's rescindment will have on courts called on to adjudicate merger challenges. Nevertheless, companies contemplating M&A transactions should be mindful of the potential consequences of the evolving antitrust enforcement landscape when evaluating and structuring transactions.

For the full text of our memorandum, please see:

- https://www.paulweiss.com/media/3981401/ftc_rescinds_vertical_guidelines_introducing_opacity_into_merger_review.pdf

For the FTC's majority statement on the withdrawal of the Vertical Merger Guidelines, please see:

- https://www.ftc.gov/system/files/documents/public_statements/1596396/statement_of_chair_lina_m_khan_commissioner_rohit_chopra_and_commissioner_rebecca_kelly_slaughter_on.pdf

For the FTC and DOJ's jointly issued Vertical Merger Guidelines, please see:

- https://www.ftc.gov/system/files/documents/reports/us-department-justice-federal-trade-commission-vertical-merger-guidelines/vertical_merger_guidelines_6-30-20.pdf

For our previous commentary on the Vertical Merger Guidelines, please see:

- https://www.paulweiss.com/practices/litigation/antitrust/publications/doj-and-ftc-issue-final-vertical-merger-guidelines?id=37456

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

**Matthew W. Abbott**
+1-212-373-3402
mabbott@paulweiss.com

**Christopher J. Cummings**
+1-416-504-0522
ccummings@paulweiss.com

**Andrew J. Foley**
+1-212-373-3078
afoley@paulweiss.com

**Adam M. Givertz**
+1-416-504-0525
agivertz@paulweiss.com

**Audra J. Soloway**
+1-212-373-3289
asoloway@paulweiss.com

**Stephen C. Centa**
+1-416-504-0527
scenta@paulweiss.com

**Christian G. Kurtz**
+1-416-504-0524
ckurtz@paulweiss.com

**Rosita Lee**
+1-212-373-3564
rlee@paulweiss.com

**Andrea Quek**
+1-416-504-0535
aquek@paulweiss.com

*Associates Thea Winterton-Perks and Katharine Wilson and Law Clerk Ben Mayer-Goodman contributed to this Client Memorandum.*