Paul | Weiss

CLIENT MEMORANDUM

January 18, 2023

2022 Year-End U.S. Legal & Regulatory Developments

In This Issue:

The following is our summary of significant 2022 U.S. legal and regulatory developments of interest to Canadian companies and their advisors. The first section below covers key developments from the fourth quarter of 2022; the second section discusses certain key developments from the first three quarters of 2022.

Recent Developments (Fourth Quarter 2022)

1. SEC Adopts Final Rules Regarding 10b5-1 Trading Plans and Disclosures for Executive Officer Equity Grants and Gifts

On December 14, 2022, the SEC adopted final rules amending Rule 10b5-1 under the Securities Exchange Act of 1934, as amended (the "Exchange Act"). Rule 10b5-1(c) provides an affirmative defense to insider trading liability under Rule 10b-5 where the trading person can show that a trade is made pursuant to a contract, instruction or plan (a "10b5-1 plan") entered into at a time when the person was not in possession of material nonpublic information, that specifies the amount of securities to be sold and the pricing and timing parameters of such sales, and over which the person does not exercise any subsequent influence. The amendments address areas where the SEC sees the potential for abusive practices by imposing mandatory cooling-off periods, eliminating the use of multiple or overlapping 10b5-1 plans and requiring significantly more disclosures regarding trading by issuers and insiders (under 10b5-1 plans and otherwise).

Under the final amendments:

- the conditions of the affirmative defense under Rule 10b5-1 will require not only that the seller entered into the 10b5-1 plan in good faith, but also that such person "has acted in good faith with respect to" the 10b5-1 plan;
- 10b5-1 plans by directors and officers will be required to include a mandatory cooling-off period between adoption of the plan and the first trade

thereunder of the later of (i) 90 days and (ii) two business days following the filing of the Form 10-Q or 10-K (or 6-K or 20-F) covering the fiscal quarter in which the plan was adopted, and in any event ending no later than 120 days after the adoption of the plan;

- 10b5-1 plans by persons other than officers and directors will be required to include a mandatory 30-day cooling-off period between the adoption of a plan and the first trade thereunder;
- 10b5-1 plans by issuers will not require a cooling-off period;
- most modifications of a plan will trigger a new cooling-off period, but the SEC has clarified that modifications that do not change the sales or purchase prices or price ranges, the amount of securities to be sold or purchased or the timing of transactions, will not trigger a new cooling-off period;
- other than for issuers, the Rule 10b5-1 affirmative defense will not be available for multiple or overlapping trading plans (which are plans allowing trades in the same period), or more than one single-trade plan in any 12-month period (with exceptions in both cases for sell-to-cover plans solely to satisfy tax withholding obligations on vesting of equity awards);
- when adopting a 10b5-1 plan, officers and directors will be required to include representations in the 10b5-1 plan certifying that they are not aware of any material nonpublic information, and they are adopting the plan in good faith and not as part of a scheme to evade the insider trading laws;
- U.S. issuers, but not foreign private issuers, will be required to disclose, on a quarterly basis, in their Form 10-Q or Form 10-K, information regarding the adoption and termination of 10b5-1 trading plans and other trading plans by its officers and directors;
- issuers will be required to disclose annually in their Annual Reports on Form 10-K or 20-F whether they have adopted an insider trading policy and if not, why not, and to file such policy as an exhibit to their annual report on Form 10-K or 20-F. Multijurisdictional disclosure system ("MJDS") issuers will not be required to make such disclosures; and
- U.S. issuers, but not foreign private issuers, will be required to provide new annual quantitative disclosures in their annual meeting proxy statement on Schedule 14A and/or Annual Report on Form 10-K regarding equity award grants made within the period commencing four business days prior to and ending the business day after the issuer's disclosure of material nonpublic information (including earnings releases, quarterly and annual reports and other current reports on Form 8-K).

The amendments will become effective on February 27, 2023. The amendments will not affect the availability of the affirmative defense under an existing 10b5-1 plan that was entered into prior to the effective date. Issuers will be required to comply with the new disclosure requirements in Exchange Act periodic reports on Forms 10-Q, 10-K and 20-F in the first filing that covers the first full fiscal period that begins on or after April 1, 2023.

For the full text of our memorandum, please see:

- https://www.paulweiss.com/media/3982860/sec_adopts_final_rules_regarding_10b5_1_trading_plans_and_disclosures_for_executive_officer_equity_grants_and_gifts.pdf

For the SEC's final rules, please see:

- https://www.sec.gov/rules/final/2022/33-11138.pdf

2. SEC Adopts Final Clawback Rules

The SEC has adopted final rules to implement Section 954 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"). New Rule 10D-1 under the Exchange Act mandates national securities exchanges and associations to establish listing standards requiring all listed companies to adopt and comply with compensation recovery (or "clawback") policies for incentive-based compensation received by current and former executive officers based on financial statements that are subsequently restated, and to disclose their clawback policies in accordance with SEC rules. The new rules apply to all companies listed in the United States (including emerging growth companies, smaller reporting companies, controlled companies and foreign private issuers, including MJDS issuers), except for certain registered investment companies.

Exchanges have until February 26, 2023 to file proposed listing standards, which must become effective no later than November 28, 2023. Listed companies will be required to adopt clawback policies within 60 days of the date on which the applicable listing standards become effective, and must begin to disclose such policies and how they apply in the annual reports and proxy/information statements filed after they adopt such policy. Exchanges will be required to prohibit the initial or continued listing of any security of an issuer that is not in compliance with the clawback rules.

Clawback Requirement

What is the clawback requirement? If a listed company is required to prepare an accounting restatement due to material noncompliance with any financial reporting requirement under the securities laws, the company will be required to recover, pursuant to its policy, incentive-based compensation received by current and former executive officers during the three completed fiscal years immediately preceding the date on which the company is required to prepare the accounting restatement. Recovery will be required on a "no fault" basis, without regard to whether any issuer or executive misconduct occurred or to an executive officer's responsibility for the erroneous financial statements.

Who is subject to the clawback requirement? New Rule 10D-1 applies to current and former executive officers of listed companies. The definition of "executive officer" is modeled on the definition of "officer" under Section 16 of the Exchange Act and includes the company's president, principal financial officer, principal accounting officer (or controller), any vice president in charge of a principal business unit, division or function and any other person who performs policy-making functions for the company (including executive officers of a parent or subsidiary).The rules prohibit a company from insuring or indemnifying an executive officer for the loss of compensation that the officer is required to pay back under the clawback policy, whether directly or indirectly.

How much would be required to be clawed back? Companies will be required to recover the amount of incentive-based compensation paid that exceeds the amount the executive officer would have received during the applicable period had the incentive-based compensation been determined based on the restated financial statements. The recoverable amount is to be calculated on a pre-tax basis.

What constitutes "an accounting restatement due to the material noncompliance of the company with any financial reporting requirement"? While the SEC has chosen not to define "accounting restatement" or "material noncompliance" for the purpose of new Rule 10D-1 (companies are to look to existing accounting standards and guidance), it has clarified its interpretation that both big "R" restatements (to correct an error material to previously issued financial statements) and little "r" restatements (to correct errors that were not material to those previously issued financial statements, but would result in a material misstatement if (a) the errors were left uncorrected in the current report or (b) the error correction was recognized in the current period) will trigger a clawback. Certain restatements, including those due to changes in accounting principles, certain internal restructurings, certain adjustments in connection with business combinations and revisions due to stock splits, would not be considered corrections triggering clawbacks.

Will the company be required to recover all such erroneously awarded incentive compensation? The unqualified "no-fault" recovery mandate of the clawback provisions means that companies will be required to pursue recovery unless they have determined that such recovery would be impracticable because either (i) the direct costs of enforcing recovery would exceed the amount to be recovered (though companies must make a reasonable attempt at recovery and must provide documentation of these efforts to the exchange), (ii) for foreign private issuers, recovery would violate home country law of the jurisdiction of incorporation adopted prior to November 28, 2022 (issuers would be required to provide an opinion of counsel acceptable to the exchange), or (iii) recovery would likely cause an otherwise tax-qualified retirement plan to fail to meet certain ERISA requirements. In addition, in all three of these cases, the committee of independent directors responsible for executive compensation (or, in the absence of one, a majority of the independent directors) must also determine that recovery would be impracticable.

Incentive-Based Compensation

What will be included in "incentive-based compensation"? "Incentive-based compensation" is defined as "any compensation that is granted, earned or vested based wholly or in part upon the attainment of any financial reporting measure." "Financial reporting measures" are measures that are determined and presented in accordance with the accounting principles used in preparing the company's financial statements, any measures derived wholly or in part from such financial information (including non-GAAP measures) and stock price and total shareholder return. Certain compensation, such as bonuses paid solely upon satisfying one or more subjective standards, non-equity incentive plan awards earned solely upon satisfying one or more strategic or operational measures and equity awards the grant of which is not contingent upon achieving any financial reporting measure performance goal and the vesting of which is contingent solely upon the attainment of non-financial reporting measures and/or completion of a specified employment period (e.g., time vested RSUs) would not be considered incentive-based compensation.

When will incentive-based compensation be deemed to be "received" for the purposes of the clawback rules? Incentive-based compensation will be deemed received in the fiscal period during which the financial reporting measure specified in the incentive-based compensation award was attained, even if the payment or grant occurs after the end of that period. Under this standard, the date of receipt would depend on the terms of the award. If the grant of an award is based, either wholly or in part, on satisfaction of a financial reporting measure, the award would be deemed received in the fiscal period when that measure was satisfied, even if paid or granted after the end of that period. If an equity award vests upon satisfaction of a financial reporting measure, the award would be deemed received in the fiscal period when it vests.

How will the amount to be clawed back in respect of incentive-based compensation based on stock price or total shareholder return be calculated? For incentive-based compensation based on stock price or total shareholder return, companies may use a reasonable estimate of the effect of the restatement on the applicable measure to determine the amount to be recovered (companies will be required to provide documentation of their calculation to the exchange).

Disclosure Requirements

Where will companies disclose their clawback policies? Each listed company will be required to file its compensation recovery policy as an exhibit to its applicable Exchange Act annual report on Form 10-K, 20-F or 40-F.

What do companies need to disclose regarding clawed back compensation? If, during its last completed fiscal year, the company either was required to prepare a restatement that required recovery of excess incentive-based compensation, or there was an outstanding balance of excess incentive-based compensation relating to a prior restatement, the company must disclose:

- the date on which it was required to prepare each accounting restatement;
- the aggregate dollar amount of excess incentive-based compensation attributable to the restatement (including an analysis of how that amount was calculated);
- if the incentive-based compensation was based on a stock price or total shareholder return metric, the estimates used and an explanation of the methodology used for such estimates;

- the aggregate dollar amount that remained outstanding at the end of its last completed fiscal year;
- if the aggregate dollar amount of excess incentive-based compensation has not been determined, the fact that it has not been determined, and the reasons for the lack of determination;
- in such case, the information must be disclosed in the next annual report or proxy/information statement containing compensation disclosure;
- if the company has determined that recovery of some or all excess incentive-based compensation would be impracticable;
- for each current and former named executive officer, the amount of recovery forgone and a brief description of the reason(s) the company has not pursued recovery; and
- for all other current and former executive officers as a group, the aggregate amount of recovery forgone and a brief description of the reason(s) the company has not pursued recovery;
- if amounts of excess incentive-based compensation paid to any current or former named executive officer are outstanding for 180 days or more, the name of and amount due from such person at the end of the company's last completed fiscal year; and
- if the company prepared an accounting restatement and concluded that no clawback was required, a brief explanation why the application of its clawback policy resulted in this conclusion.

The disclosure would be included along with the listed company's other executive compensation disclosure in annual reports on Forms 10-K, 20-F and 40-F and any proxy or information statements in which executive compensation disclosure is required, and for registered management investment companies subject to Rule 10D-1, in annual reports on Form N-CSR and in proxy statements and information statements relating to the election of directors. Disclosure will not be deemed incorporated by reference into any filing under the Securities Act of 1933, as amended, unless specifically done so. Listed companies will also be required to tag specific data points and to block tag the disclosure in an interactive data format using eXtensible Business Reporting Language (XBRL).

The new rules also include amendments to the Summary Compensation Table disclosure requirements if a clawback has been effected. A new instruction to the Summary Compensation Table will require that any amounts recovered pursuant to a listed company's erroneously awarded compensation recovery policy reduce the amount reported in the applicable column, as well as the total column for the fiscal year in which the amount recovered initially was reported, and be identified by footnote.

How will companies disclose restatements that are not correcting a material error to previously issued financial statements?
Because a Form 8-K is not typically filed for an error that is not material to the previously issued financial statements, the SEC is amending the cover pages of Form 10-K, Form 20-F and Form 40-F to add check boxes for companies to indicate (a) whether the financial statements included in the filing include an error correction to previously filed financial statements and (b) whether any such corrections are restatements that triggered a clawback analysis during the fiscal year.

For the full text of our memorandum, please see:

- https://www.paulweiss.com/media/3982698/sec_adopts_final_clawback_rules.pdf

For the SEC's final rules, please see:

- **Error! Hyperlink reference not valid.**https://www.sec.gov/rules/final/2022/33-11126.pdf

3. Nasdaq Updates Board Diversity Deadlines

Nasdaq has amended the deadlines for its board diversity requirements, changing to a uniform December 31st cutoff in the applicable year of compliance (instead of an August or later proxy filing date deadline). Because the rules require these disclosures by the time of a company's annual meeting proxy statement filing (or Form 10-K or 20-F filing, as applicable), even if disclosed via website, these revised dates will not practically affect the compliance schedule for most Nasdaq companies. The amendments are effective immediately, and the revised compliance dates are as follows:

- each Nasdaq-listed company must have at least one director who self-identifies as diverse, meaning female or an "Underrepresented Minority" (Black or African American, Hispanic or Latinx, Asian, Native American or Alaska Native, Native Hawaiian or Pacific Islander, two or more races or ethnicities, or LGBTQ+) or alternatively explain why the company does not meet these board diversity objectives by December 31, 2023 (instead of the later of August 7, 2023, or the date of the company's proxy/information statement for its 2023 annual meeting); and

- each Nasdaq Global Select- and Global Markets-listed company must 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 alternatively explain why the company does not meet these board diversity objectives by December 31, 2025 (instead of the later of August 7, 2025, or the date of the company's proxy/information statement for its 2025 annual meeting). Nasdaq Capital Markets-listed companies have an additional year to meet these board diversity objectives (by December 31, 2026).

These listing requirements apply to foreign private issuers, including MJDS issuers that file annual reports on Form 40-F, and smaller-reporting companies. 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.

Nasdaq also clarified that the outside deadline for listed companies must provide statistical disclosures regarding the self-identified diversity characteristics of its board members in Nasdaq's prescribed board diversity matrix format is December 31st of each year on a go-forward basis, though these disclosures too must be made by the time of a company's annual meeting proxy statement filing (or Form 10-K or 20-F filing, as applicable).

As noted above, under existing rules, companies may make the required disclosures (i) in any proxy statement or any information statement (or, if the company does not file a proxy, in its Form 10-K or 20-F) or (ii) on the company's website. However, companies disclosing via their website must submit the URL link to the disclosure concurrently with the proxy statement (or Form 10-K or 20-F filing, as applicable) to Nasdaq through the Nasdaq Listing Center via email to drivingdiversity@nasdaq.com. Nasdaq has provided companies with robust guidance on compliance with these rules, including FAQs, an information sheet and examples of acceptable board diversity matrices.

The SEC's approval of Nasdaq's board diversity requirements is being challenged before the U.S. Court of Appeals for the Fifth Circuit.

For the full text of our memorandum, please see:

- https://www.paulweiss.com/media/3982876/nasdaq_updates_board_diversity_deadlines.pdf

4. Glass Lewis and ISS Issue 2023 Voting Policies for U.S. Companies

Proxy advisory firms Glass Lewis and Institutional Shareholder Services ("ISS") have issued final voting policy updates for the 2023 proxy season that are applicable to U.S. Companies. Key changes include board diversity and oversight, executive compensation, environmental and social ("E&S") issues and board accountability, in line with continuing shareholder focus on environmental, social and governance issues.

Board Diversity

Glass Lewis. Glass Lewis will begin recommending against the chair of the nominating/governance committee ("NGC") of a Russell 3000 company board that is not at least 30 percent gender diverse (inclusive of women and directors that identify as other than male or female). For non-Russell 3000 companies, Glass Lewis's existing policy requiring one gender diverse director will continue to apply. Glass Lewis may refrain from recommending against directors if boards provide a sufficient rationale or plan to address such lack of diversity, including a timeline to appoint gender-diverse directors (generally by the next annual meeting).

- **Underrepresented Community Diversity**. Beginning in 2023, Glass Lewis will generally recommend against the NGC chair of a Russell 1000 company with no director from an underrepresented community (i.e., Black, African American, North African, Middle Eastern, Hispanic, Latino, Asian, Pacific Islander, Native American, Native Hawaiian, Alaskan Native, gay, lesbian, bisexual or transgender). Glass Lewis will rely solely on self-identified information in company proxy statements for this purpose. As with gender diversity, Glass Lewis may refrain from recommending against directors if boards provide a sufficient rationale or plan to address such lack of diversity, including a timeline to appoint directors from an underrepresented community (generally by the next annual meeting).

- **State Law Requirements**. Some states have encouraged board diversity through legislation, and in 2022, Glass Lewis announced a policy generally to recommend in line with applicable state laws mandating board composition requirements. Since then, Sections 301.3 and 301.4 of the California General Corporation Law (together, the "California laws") mandating board gender and underrepresented community diversity, respectively, were deemed to violate the equal protection clause of the California state constitution. Pending appeal of the decision (which is ongoing), Glass Lewis will refrain from recommending in accordance with the California laws until further notice, but will monitor the appeal and company compliance with these requirements.

ISS. The existing ISS policy to recommend against the nominating committee chair (or other directors on a case-by-case basis) at boards with no women directors will be extended to all companies (not just Russell 3000 and S&P 1500 companies). As is currently the case, an exception will be made if there was at least one woman on the board at the prior annual meeting and the board makes a firm commitment to return to a gender-diverse status within a year.

ESG Initiatives

Glass Lewis. Glass Lewis will generally recommend against NGC chairs at Russell 1000 companies that do not provide explicit disclosure about the board's role in overseeing E&S issues, though boards should determine the best structure for this oversight, whether by specific directors, the entire board, a separate committee or one of the key existing committees. Beginning in 2023, Glass Lewis will expand its tracking of board-level oversight of E&S issues to the Russell 3000 index. It will examine a company's proxy statement and governing documents (e.g., committee charters) to determine if directors maintain a meaningful level of oversight and accountability for a company's material E&S risks.

In both its 2023 U.S. voting and ESG Initiatives guidelines, Glass Lewis has included a new discussion on director accountability for climate-related issues. For companies whose own greenhouse gas ("GHG") emissions represent a financially material risk, such as those identified by groups including Climate Action 100+, Glass Lewis believes that clear and comprehensive disclosure regarding climate risks should be provided, including how they are being mitigated and overseen. These disclosures should be in line with the recommendations of the Task Force on Climate-related Financial Disclosures, and the boards of these companies should have explicit and clearly defined oversight responsibilities for climate-related issues. Glass Lewis may recommend against the responsible directors in cases where these disclosures are absent or significantly lacking.

ISS. In 2022, ISS added a policy for the United States (and also for select other markets) providing that for companies that are significant GHG emitters (i.e., those in the Climate Action 100+ Focus Group), ISS would recommend against the chair of the responsible committee (or other directors on a case-by-case basis) if ISS determines that the company is not taking the "minimum steps" needed to understand, assess and mitigate risks related to climate change to the company and the larger economy. "Minimum steps" required satisfaction of the following criteria: (i) detailed disclosure of climate-related risks (such as disclosure prepared in accordance with the guidelines provided by the Task Force on Climate-related Financial Disclosures) and (ii) "appropriate GHG emissions reduction targets," which in 2022 meant any well-defined GHG reduction targets (and did not need to include Scope 3 emissions), but should cover at least a significant portion of the company's direct emissions. For 2023, ISS will define "appropriate GHG emissions reductions targets" to be "medium-term GHG reduction targets or Net Zero-by-2050 GHG reduction targets for a company's operations (Scope 1) and electricity use (Scope 2)," and that such targets should cover the vast majority (i.e., 95%) of the company's direct emissions. While ISS will apply the same analysis framework for all Climate Action 100+ Focus Group companies globally, there will be "differentiated implementation of any negative vote recommendations based on relevant market and company factors."

Voting Rights

ISS. Since 2015, ISS has had a policy to recommend against the boards at newly public companies that have a common stock structure with unequal voting rights without a sunset of less than seven years from the date of initial public offering ("IPO"). As previously announced, ISS will extend this policy to all covered companies in 2023. Further, the exception for companies with a seven-year sunset is only available to newly public companies (i.e., companies that emerge from bankruptcy, special purpose acquisition company ("SPAC") transactions, spin-offs, direct listings and those who complete a traditional IPO). Other exceptions include (i) limited partnerships and the operating partnership units of REITs, (ii) companies where the super-voting shares represent less than 5% of total voting power and (iii) those companies where there is sufficient protection for minority shareholders, e.g., if minority shareholders are given a regular binding vote on whether the capital structure should remain in place. ISS previously clarified that unequal vote structures include high/low vote stock, classes of shares that are not entitled to vote on all the same ballot items or nominees and stock with time-phased voting rights.

Exculpation of Officers

Glass Lewis. In August 2022, the Delaware General Corporation Law was amended to permit Delaware corporations to limit or eliminate the personal liability of officers for certain claims involving a breach of the duty of care. Glass Lewis will evaluate proposals to adopt such officer exculpation provisions on a case-by-case basis, and will generally recommend against such proposals unless a compelling rationale for the adoption is provided by the board and the provisions are reasonable.

ISS. For 2023, ISS has adopted a new policy to recommend, on a case-by-case basis, proposals providing for officer exculpation, taking into account specified factors, such as whether the provisions would eliminate officer liability for violations of the duty of care or the duty of loyalty. Such exculpation should be limited to the company's president, chief executive officer, chief operating officer, chief financial officer, chief legal officer, controller, treasurer or chief accounting officer, "named executive officers" in the company's Securities and Exchange Commission ("SEC") filings and individuals who agree to be identified as officers of the corporation. As with director exculpation, Delaware law does not permit officers to be exculpated for breaches of the duty of loyalty, acts or omissions not in good faith or that involve intentional misconduct or a knowing violation of law, any transaction in which the officer derived an improper personal benefit or for derivative claims. Other states (including, for example, Nevada) allow companies to limit the liability of directors and officers even for violations of the duty of loyalty, and ISS will generally recommend against these types of exculpation provisions.

For the full text of our memorandum on Glass Lewis' 2023 voting policies, please see:

- https://www.paulweiss.com/media/3982792/glass_lewis_issues_2023_voting_policies.pdf

For the full text of our memorandum on ISS' 2023 voting policies, please see:

- https://www.paulweiss.com/media/3982827/iss_issues_final_policy_updates_for_2023_proxy_season.pdf

For Glass Lewis' U.S. 2023 policy guidelines, please see:

- https://www.glasslewis.com/wp-content/uploads/2022/11/US-Voting-Guidelines-2023-GL.pdf?hsCtaTracking=45ff0e63-7af7-4e28-ba3c-7985d01e390a%7C74c0265a-20b3-478c-846b-69784730ccbd

For ISS' 2023 proposed policy changes, please see:

- https://www.issgovernance.com/file/policy/2022/2023-Benchmark-Policy-Changes-For-Comment.pdf

5. Mandatory Electronic Filing of Form 144

As of April 13, 2023, Form 144 will be required to be filed with the SEC via EDGAR. Form 144 may be filed electronically now, but other forms of submission, including paper submissions mailed to the SEC and email submissions, are still permitted and accepted until April 13, 2023. Form 144s filed via EDGAR will be accepted for filing until 5:30 p.m. on those days that EDGAR is open.

In order to prepare to meet these upcoming requirements, we encourage our clients to review their SEC filing codes to ensure adequate time to apply for new codes or update accounts, as necessary. Form 144 must be filed by any affiliate of a public company who wishes to sell more than 5,000 shares, or shares with an aggregate sale price in excess of $50,000, in reliance on Rule 144.

For the full text of our memorandum, please see:

- https://www.paulweiss.com/media/3982833/mandatory_electronic_filing_of_form_144.pdf

6. New FTC Policy Has Potential to Significantly Broaden "Unfair Methods of Competition" Enforcement

On November 10, 2022, the FTC issued a Policy Statement Regarding the Scope of Unfair Methods of Competition Under Section 5 of the Federal Trade Commission Act of 1914 (the "FTC Act"). This comes after the FTC rescinded an earlier Section 5 policy statement last year. In the new policy statement, the FTC sets out various criteria it will use to determine whether a method of competition is "unfair" and therefore violates Section 5.

Section 5 of the FTC Act declares "unfair methods of competition" to be "unlawful" and "empower[s] and direct[s]" the FTC to prevent persons, corporations and certain other entities from using such methods. To do so, the FTC may bring an administrative proceeding for a cease and desist order. Also, if the FTC believes that a violation is occurring or about to occur, it may seek an injunction in federal district court. (There is no private right of action for Section 5 violations.) The FTC Act does not define "unfair methods of competition."

Much of the debate surrounding Section 5 concerns the extent to which it is broader than the Sherman Act, which prohibits unreasonable restraints of trade and monopolization, or the Clayton Act, which governs mergers and acquisitions. The FTC has long asserted a "standalone" Section 5 authority, but until recently it was the policy of the FTC to use this authority only in narrow circumstances. For example, under the earlier policy, in "deciding whether to challenge an act or practice as an unfair method of competition in violation of Section 5 on a standalone basis," the FTC would "be guided by the public policy underlying the antitrust laws, namely, the promotion of consumer welfare." Under that policy, "an act or practice challenged by the Commission [using standalone authority] must cause, or be likely to cause, harm to competition or the competitive process, taking into account any associated cognizable efficiencies and business justification." In practice, this meant that the FTC rarely brought Section 5 actions.

The FTC's new policy is much broader. According to the FTC's new statement, "unfair" competition involves conduct that is "coercive, exploitative, collusive, abusive, deceptive, predatory, or [that] involve[s] the use of economic power of a similar nature," or is "restrictive or exclusionary." Also, "the conduct must tend to negatively affect competitive conditions." The policy statement says that this "may include, for example, conduct that tends to foreclose or impair the opportunities of market participants, reduce competition between rivals, limit choice, or otherwise harm consumers" and includes "raising prices, reducing output, . . . reducing innovation, . . . or reducing the likelihood of potential or nascent competition." The policy "is purposely focused on incipient threats to competitive conditions" rather than on "whether the conduct directly caused actual harm in the specific instance at issue."

Of course, many of these concepts are already found in the Sherman Act. For example, Section 1 prohibits certain types of collusion; and, depending on the circumstances, Section 2 generally prohibits monopolists from engaging in coercive, exploitative, abusive, predatory or exclusionary conduct, or conduct that forecloses markets. Other laws prohibit deceptive acts. But one key distinction between the Sherman Act and the FTC's interpretation of Section 5 is that, in the FTC's view, Section 5 applies to "incipient" threats to competition. The FTC's statement also says that "Section 5 does not require a separate showing of market power or market definition when the evidence indicates that such conduct tends to negatively affect competitive conditions." Indeed, as this suggests, "the inquiry will not focus on the 'rule of reason'" used in evaluating many Sherman Act claims. The rule of reason generally allows the weighing of procompetitive justifications, but the FTC's new policy expressly limits the circumstances in which justifications could offset a finding of unfairness.

According to the statement, the FTC will weigh unfairness and negative effects on competitive conditions on a "sliding scale" such that "less may be necessary to show a tendency to negatively affect competitive conditions" when unfairness is clear. According to the statement, the "size, power, and purpose of the respondent may be relevant, as are the current and potential future effects of the conduct."

The statement lists numerous "historical examples" of unfair methods of competition, "for the purpose of providing further guidance" as to what conduct might violate Section 5. The statement notes that the examples are "illustrative" and "nonexclusive." They include: mergers "that have the tendency to ripen into violations of the antitrust laws"; serial merger activity that "that tend[s] to bring about the harms that the antitrust laws were designed to prevent, but individually may not have violated the antitrust laws"; "mergers or acquisitions of a potential or nascent competitor that may tend to lessen current or future competition"; and "interlocking directors and officers of competing firms not covered by the literal language of the Clayton Act." While the policy statement provides some examples of conduct that the FTC may seek to challenge, the statement notes that these are "non-exclusive" and "illustrative."

Significance. The FTC's action is significant because it signals that the FTC intends to take action against a broader range of conduct it deems to be unfair and therefore more companies may be targets for FTC cease and desist orders. Indeed, the expansion of conduct potentially subject to Section 5 enforcement creates the risk of introducing uncertainty into a wide range of areas and of chilling conduct (mergers and business practices) that may be lawful under the Sherman and Clayton Acts. To be sure, in any action brought under Section 5, the FTC would ultimately have to persuade a court to agree with it if a defendant mounts a challenge. It remains to be seen what types of enforcement actions the FTC will bring under this new policy and companies would do well keep up to date on FTC enforcement actions in this evolving area.

For the full text of our memorandum, please see:

- https://www.paulweiss.com/media/3982749/new_ftc_policy_has_potential_to_significantly_broaden_unfair_methods_of_competition_enforcement.pdf

For the FTC policy statement, please see:

- https://www.ftc.gov/system/files/ftc_gov/pdf/P221202Section5PolicyStatement.pdf

7. Treasury Department Issues First-Ever CFIUS Enforcement and Penalty Guidelines

On October 20, 2022, the U.S. Department of the Treasury (the "Treasury"), in its position as Chair of the Committee on Foreign Investment in the United States ("CFIUS"), the interagency committee authorized to review certain transactions involving non-U.S. investment into the United States, issued its first-ever enforcement and penalty guidelines (the "Guidelines") for a violation of the CFIUS regulations (31 C.F.R. Parts 800-802). The Guidelines provide background and context with respect to the CFIUS enforcement process and a non-exhaustive list of aggravating and mitigating factors that CFIUS will consider in any enforcement action.

In issuing the Guidelines, the Treasury noted the importance of prompt and complete self-disclosure of any conduct that may constitute a violation of the CFIUS regulations and established a self-disclosure mechanism. The Guidelines do not, however, include penalty mitigation or other concrete incentives that appear in other Treasury regulatory regimes (e.g., economic sanctions regulations). The issuance of the Guidelines may reflect a decision by CFIUS to increase its use of the enhanced enforcement authorities provided to it under the Foreign Investment Risk Review Modernization Act ("FIRRMA"), particularly in the context of violations of CFIUS mitigation agreements, failures to make mandatory filings and material factual misstatements or omissions. The Guidelines also offer more transparency with respect the CFIUS enforcement and penalty process, which has historically been opaque.

Three Categories of Conduct That May Constitute a Violation

The Guidelines identify three types of conduct subject to CFIUS enforcement and penalties. The Guidelines specifically note, however, that not all violations will necessarily result in an enforcement action or penalties, and that CFIUS will exercise its enforcement discretion in light of certain aggravating and mitigating factors.

The types of conduct that constitute a violation of the CFIUS regulations that may result in enforcement are:

- the failure to submit a mandatory declaration or notice;
- engaging in conduct that is prohibited by or otherwise fails to comply with CFIUS mitigation agreements, conditions or orders (collectively, "CFIUS Mitigation"); and
- material misstatements in or omissions in information filed with CFIUS, and false or materially incomplete certifications filed in connection with assessments, reviews, investigations or CFIUS Mitigation, including information provided during informal consultations or in response to requests for information.

Sources of Information on Which CFIUS Relies

The Guidelines note that, in determining whether a violation of the CFIUS regulations has occurred, CFIUS considers information from a variety of sources, including from across the U.S. government, publicly available information, third-party service providers (e.g., auditors or monitors), tips, transactions parties and filing parties.

The Guidelines highlight information that may come from the parties to a transaction or filings themselves as a particular focus of CFIUS, including:

- **Responses to Requests for Information**. CFIUS often requests information from relevant parties and may consider a party's cooperation with such requests to be a mitigating factor in an enforcement action related to the information sought.
- **Self-Disclosures**. The Guidelines include the first-ever discussion of voluntary self-disclosures regarding potential violations of the CFIUS regulations and note that the timely self-disclosure of potential violations of the CFIUS regulations (including CFIUS Mitigation) would generally be considered to be a mitigating factor.

- **Tips**. The Guidelines actively encourage the reporting of any tips regarding potential violations of the CFIUS regulations to CFIUS and provide email and phone contacts to report such tips to CFIUS.

Penalty Process

The Guidelines note, that, as required by the CFIUS regulations, prior to taking an enforcement action, CFIUS will send the target of the action a notice of penalty, which must include a written explanation of the violation, the amount of the proposed monetary penalty and any aggravating and mitigating factors that CFIUS has considered. The Guidelines note that the recipient of a notice of penalty may, within 15 business days of receiving the notice, submit a petition for reconsideration to the CFIUS Staff Chairperson, including any defense, mitigating factors or explanation. CFIUS must then consider the issues raised and issue a final penalty determination within 15 business days following the receipt of a petition for reconsideration.

Aggravating and Mitigating Factors

The Guidelines state that, when determining any appropriate penalty in response to an identified violation, CFIUS will engage in a "fact-based analysis in which it weighs aggravating and mitigating factors" and that the weight CFIUS may give to any factor will "necessarily vary depending upon the particular facts and circumstances" surrounding the conduct at issue.

The Guidelines include a non-exhaustive list of potential aggravating and mitigating factors that CFIUS may consider, depending upon the facts and circumstances of a given violation, including:

- accountability for the violative conduct (the impact of the enforcement action on protecting national security and/or holding violative parties accountable for their actions and incentivizing future compliance with the CFIUS regulations);

- harm (whether and the extent to which the violative conduct impacted U.S. national security);

- negligence, awareness and intent (the extent to which the conduct was the result of simple negligence, gross negligence, intentional action or willfulness, as well as whether there were any efforts to conceal the violation or delay the sharing of relevant information regarding the violation with CFIUS);

- persistence and timing (the length of time that a violative party had been aware, or had reason to be aware, of a potential violation prior to CFIUS becoming aware of the violation);

- response and remediation (whether the violative party self-disclosed the violation, whether the violative party cooperated fully in the CFIUS investigation and whether the violative party performed a root cause analysis regarding the violation and took appropriate remedial actions to prevent future violations); and

- sophistication and past record of compliance (including the violative party's history and familiarity with CFIUS, its past compliance with CFIUS Mitigation and its internal and external resources dedicated to compliance).

Implications

Although the Guidelines state that they are not binding and may be updated in the future, their issuance suggests that CFIUS intends to make use of the enhanced enforcement authorities conferred on it by FIRRMA to strengthen enforcement of the CFIUS regulations, particularly with regard to compliance with CFIUS Mitigation. To date, CFIUS has announced only two penalty actions: (1) a $1 million civil penalty imposed in 2018 for repeated breaches of a 2016 CFIUS mitigation agreement, including failure to establish requisite security policies and failure to provide adequate reports to CFIUS and (2) a $750,000 civil penalty imposed in 2019 for violations of a 2018 CFIUS interim order, including failure to restrict and adequately monitor access to protected data. CFIUS has authority under FIRRMA to impose substantially higher penalties, including civil fines up to the value of a given transaction for failure to make a mandatory CFIUS filing and for violating a CFIUS mitigation agreement or order. With such potential penalties in the background, the Guidelines highlight the importance of non-U.S. investors and their U.S. targets performing appropriate CFIUS diligence in transactions, particularly to determine whether a mandatory filing is triggered, and for all parties subject to CFIUS Mitigation to devote appropriate resources to ensure compliance with such CFIUS Mitigation.

For the full text of our memorandum, please see:

- https://www.paulweiss.com/media/3982350/ofac_enforcement_action_again-highlights_the_importance_of_ip_address-blocking_ofac_also_issues_guidance-for_instant_payments_industry.pdfhttps://www.paulweiss.com/media/3982718/treasury_department_issues_first_ever_cfius_enforcement_and_penalty_guidelines.pdf

For the CFIUS Enforcement and Penalty Guidelines, please see:

- https://home.treasury.gov/policy-issues/international/the-committee-on-foreign-investment-in-the-united-states-cfius/cfius-enforcement-and-penalty-guidelines

8. OFAC Enforcement Action Again Highlights the Importance of IP Address Blocking; OFAC Also Issues Guidance for Instant Payments Industry

On September 30, 2022, the Treasury's Office of Foreign Assets Control ("OFAC") announced a $116,048 settlement with Tango Card, Inc. ("Tango Card"), a U.S.-headquartered company that supplies and distributes electronic rewards, often in the form of digital stored value cards to support client businesses' employee and customer incentive programs. The settlement resolves 27,720 transactions with persons with an internet protocol ("IP") address or email address associated with Cuba, Iran, Syria, North Korea and the Crimea region that resulted in apparent violations of U.S. sanctions. OFAC determined that although Tango Card maintained IP blocking and sanctions screening procedures for its direct customers (i.e., merchants), Tango Card did not maintain such procedures with regard to the recipients of rewards (i.e., the merchant's customers and employees) despite collecting information, including such recipients' IP addresses and email addresses, during the normal course of its business.

This enforcement action emphasizes the importance of effective screening not only for designated persons (including those persons on the SDN List), but also for persons located in comprehensively sanctioned jurisdictions—including ensuring that shipping or billing address information, IP addresses or email address suffixes collected during the normal course of a company's business are screened. This enforcement action thus reinforces several recent OFAC enforcement actions in which OFAC faulted companies in the cryptocurrency space, and a payment processor for similar deficiencies in their sanctions screening and IP blocking procedures.

On the same day, OFAC separately issued new guidance entitled Sanctions Compliance Guidance for Instant Payment Systems (the "Guidance") that discuss approaches that financial institutions that participate in instant real-time payments systems (and developers of these systems) can take to mitigate their sanctions compliance risks. OFAC stated that it was issuing the Guidance to "(i) reaffirm that financial institutions should take a risk-based approach to managing sanctions risks; (ii) highlight key factors that may be relevant in determining that risk-based approach; (iii) encourage the development and deployment of innovative sanctions compliance approaches and technologies to address identified risks; and (iv) encourage developers of instant payment systems to incorporate sanctions compliance considerations as they develop new payment technologies." The Guidance also noted that OFAC issued the Guidance to assist financial institutions in determining how to best allocate their compliance resources in a risk-based manner.

Below we provide more detail on OFAC's enforcement action and the Guidance.

The Tango Card Settlement

According to OFAC, between September 2016 and September 2021, Tango Card digitally transmitted 27,720 merchant gift cards and promotional debit cards totaling $386,828 to individuals with email or IP addresses associated with Cuba, Iran, Syria, North Korea or the Crimea region. OFAC stated that while Tango Card used geolocation tools to identify transactions involving comprehensively sanctioned jurisdictions and countries at high risk for suspected fraud for (and performed sanctions screening of) its direct customers, which were merchants, Tango Card did not use these controls to identify whether recipients of rewards, which were customers and employees of merchants, may involve comprehensively sanctioned jurisdictions, despite collecting relevant information, including IP address and top-level domains ("TLD"; i.e., email address suffixes associated with comprehensively sanctioned jurisdictions such as .ir (Iran) and .cu (Cuba)) of such recipients in the normal course of its business.

OFAC indicated that Tango Card voluntarily self-disclosed these apparent violations, which the agency determined were non-egregious. According to OFAC, the statutory maximum civil monetary penalty amount for the apparent violations was $9,168,949,062 and the base penalty amount was $193,414.

OFAC noted as aggravating factors that Tango Card "failed to impose risk-based geolocation rules using tools at its disposal to identify the location of its reward recipients, despite having reason to know that it was transmitting rewards to recipients in sanctioned jurisdictions based on IP address and TLD data in its possession."

OFAC noted several mitigating factors, including a number of remedial measures that Tango Card took to enhance its sanctions compliance framework. Among other things, OFAC praised Tango Card for taking the following measures to strengthen its sanctions compliance processes:

- "implement[ing] geo-blocking for TLDs, preventing reward issuance to email addresses associated with sanctioned jurisdictions;
- update[ing] its IP address geo blocking to include jurisdictions and regions subject to sanctions, preventing redemptions by persons in these jurisdictions;
- conduct[ing] training for the team that handles bulk spreadsheet orders for manually screening email addresses for jurisdictions and regions subject to sanctions;
- hir[ing] a consultant to review its security posture with regard to its cloud program;
- hir[ing] and continu[ing] to hire additional staff to proactively identify control gaps and improve compliance processes;
- acquir[ing] additional screening tools; and
- running two monthly reports — one identifying any TLDs over the prior month from jurisdictions and regions subject to sanctions and the other identifying any IP addresses over the prior month associated with such jurisdictions."

The Tango Card settlement agreement is one of several OFAC enforcement actions involving sanctions screening and IP blocking deficiencies in recent years. These recent enforcement actions have made clear that OFAC expects companies doing business online to screen IP address information, as well as other information that they may receive in the normal course of business (including physical address, email address suffix, TLD data and phone number prefix information) to identify a nexus with comprehensively sanctioned jurisdictions. While not discussed in this action, in other recent enforcement actions OFAC has noted that including place names associated with sanctioned jurisdictions—such as, depending on the jurisdiction, the names of cities, regions, ports and common alternative spellings of the same—in a sanctions filter can be a useful means of further detecting the potential involvement of a sanctioned jurisdiction. These recent settlements also show the importance of not only implementing sanctions screening procedures, but also of testing and auditing the implementation of those procedures to ensure that they are working in practice to identify potentially problematic transactions.

Instant Payment Systems Guidance

The Guidance does not set out one standardized approach to sanctions compliance for instant payment systems (i.e., payment systems that allow users to send and receive funds almost instantly, at any time of day on any day of the year, and which likely include cryptocurrency payment systems). Rather, the Guidance notes OFAC's expectation that financial institutions will make decisions on whether and how to screen transactions using instant payment systems based on the institutions' assessment of their own risk. OFAC noted, for example, that solely domestic (i.e., wholly in the United States) instant payment systems generally pose lower sanctions-related risks than those involving accounts maintained at non-U.S. banks, as OFAC "expects that U.S. banks, which are subject to stringent U.S. regulatory requirements and supervisory examinations, are already performing risk-based due diligence on their customers at onboarding and at regular intervals thereafter, including screening their customers to identify a potential sanctions nexus."

While OFAC noted that a payment of any amount could result in a violation of U.S. sanctions, OFAC noted that the monitoring of the nature and value of customer payments made through instant payment systems is an important piece of any financial services business' sanctions compliance framework. OFAC noted, for example, that "payments consistent with past customer behavior that a financial institution has previously vetted and cleared for potential sanctions implications generally pose lower sanctions risk than payments that appear inconsistent with a customer's prior history, such as significantly higher value payments or payments made to foreign persons with whom the customer has not previously dealt."

In the Guidance, OFAC goes on to describe new tools and technologies that financial institutions could use to mitigate their sanctions risks with respect to instant payment systems. These include artificial intelligence tools that leverage information-sharing mechanisms across financial institutions that can enhance the accuracy of sanctions screening and reduce the number of false positives. OFAC encouraged financial institutions to use and implement such tools in a manner consistent with an institution's assessment of its sanctions-related risks.

OFAC also encouraged the developers of instant payment systems to incorporate sanctions compliance during the design and development process. As an example, OFAC noted the importance of instant payment systems enabling communication between the financial institutions involved in processing payments, as such communication is often necessary to gather information related to potential sanctions screening alerts. OFAC also encouraged developers of instant payment systems to also create processes in their systems for exception processing (i.e., allowing a transaction to be removed from the automated process to provide sufficient time for a financial institution to investigate potential sanctions concerns). OFAC noted that while it understands that a key feature of instant payment systems is the near real-time nature of transaction settlement, this commercial feature should not discourage financial institutions from implementing risk-based sanctions compliance controls. Finally, OFAC called on instant payment systems to establish minimum sanctions compliance expectations for its members, including, for example, setting expectations for members regarding customer onboarding and ongoing due diligence or norms for screening transaction parties or details, as appropriate based on risk.

The Guidance makes clear that developers of instant payment systems and financial institutions that participate in instant payment systems (like all financial service providers) are responsible for ensuring that they do not engage in unauthorized transactions prohibited by U.S. sanctions and that, therefore, such businesses should develop a tailored, risk-based sanctions compliance program in line with the guidance provided by OFAC in its Framework for OFAC Compliance Commitments, as well as the Guidance. The Guidance importantly notes that while OFAC recognizes that a key commercial feature of instant payment systems is their speed, OFAC does not view this commercial consideration as outweighing or excusing the need for implementing risk-based sanctions compliance controls relating to payments through instant payment systems.

For the full text of our memorandum, please see:

- https://www.paulweiss.com/media/3982350/ofac_enforcement_action_again-highlights_the_importance_of_ip_address-blocking_ofac_also_issues_guidance-for_instant_payments_industry.pdf

For the OFAC settlement with Tango Card, please see:

- https://home.treasury.gov/system/files/126/20220930_tango_card.pdf

For the OFAC Guidance, please see:

- https://home.treasury.gov/system/files/126/instant_payment_systems_compliance_guidance_brochure.pdf

9. DOJ Loses Challenge to U.S. Sugar-Imperial Sugar Deal

After determining that the United States Department of Justice (the "DOJ") failed to meet its burden of proof, a Delaware federal court denied the government's request to enjoin the $315 million acquisition of Imperial Sugar by U.S. Sugar. The court found that the DOJ failed to prove a proper antitrust market and criticized the government's expert for, among other things, failing to take account of the realities of the sugar industry in the United States. The public version of the court's opinion was docketed on September 28. The DOJ has appealed, and the Third Circuit ordered expedited briefing but denied the DOJ's motion for an injunction pending appeal.

The DOJ sued to stop the transaction in November 2021, eight months after the deal was announced. U.S. Sugar grows and refines sugar in Florida and sells its sugar through United Sugars, a sugar-selling cooperative. Imperial is a sugar refiner that operates in Georgia and is owned by Louis Dreyfus. The government alleged that the transaction would be likely substantially to lessen competition in a market for "the production and sale of refined sugar to wholesale customers" in the "East South Central and South Atlantic United States" (or, alternatively, "the narrower region of Georgia and its bordering states").

Much of the court's opinion deals with whether sugar distributors should be included in the market along with refiners. The DOJ argued that distributors should be excluded because "they do not produce the refined sugar they are selling," but are instead "more properly considered customers." In contrast, the defendant parties to the transaction argued that distributors should be included in the market because they are "competitive sellers of refined sugar."

The court ultimately sided with the defendants, finding that the government's proposed product market was too narrow. The judge wrote that the "record is replete with evidence of distributors competing with refiner producers . . . as well as with cooperatives like United" and that "distributors account for approximately 25% of sales of refined sugar in the U.S." In particular, the court noted that distributors "can purchase large volumes of sugar from a variety of sources and move sugar to other locations in the country experiencing a sugar deficit or high prices." The court also found that because "a division of the refined sugar market into 'refiner or cooperative sold' refined sugar and 'distributor sold' refined sugar would be inconsistent with the commercial realities of the industry," the product market proposed by the DOJ had to be rejected. (Interestingly, the court also concluded that the government's proposed product market was too broad in that it included purchasers that are "industrial food and beverage producers" along with purchasers that are "retail companies" and "food service companies." The court found that the DOJ "introduced no evidence to support a finding that industrial companies have the same competitive options and purchasing behavior as any other wholesale customer included in its proposed market.")

The court went on to find that the government's proposed geographic markets were too narrow – though it noted that the lack of a proper product market "is dispositive." Here, the court cited "abundant evidence of sugar consumers" located in the proposed markets "purchasing their refined sugar outside those geographic regions." The court also found that "many customers either pick up their purchased refined sugar at locations outside" the proposed markets "or have the capacity to do so in the future." The court concluded that "the process of identifying the relevant geographic market must conform to the economic realities of the industry to recognize competition where competition exists. . . . Here, the economic reality is that sugar flows easily across the country from areas of surplus to deficit in responses to prices and demand."

Without a proper product and geographic market, the court held that the DOJ was unable to establish a prima facie case that the transaction would be anticompetitive.

In its opinion, the court was quite critical of the expert proffered by the DOJ to support its asserted market definition, writing that "his credentials and experience appear to be lacking." (Conversely, the court found the defendants' expert to be "particularly credible.") The court said that the government expert's "assumptions . . . were flawed," and his proposed market definition "was at times internally inconsistent" and inconsistent with the trial testimony of numerous witnesses. Elsewhere, the court wrote that the DOJ expert's proposed market was "simply not credible."

Notably, the court spent several pages at the end of the opinion explaining the role of the government in the U.S. sugar industry, in particular the United States Department of Agriculture's role in sugar price support. The court returned to this theme when it denied the DOJ's request for an injunction pending appeal, writing: "The United States Government, through the Federal Sugar Program administered by the United States Department of Agriculture, ensures that purchasers and consumers in the United States pay higher rates for refined sugar than those in other parts of the world."

Significance. This case illustrates the critical role of proper market definition in merger cases, the importance of credible experts (especially when relying on the expert for critical elements of a case) and the overarching relevance of real-world evidence, which, in this case, appears to have carried the day.

For the full text of our memorandum, please see:

- https://www.paulweiss.com/media/3982305/doj_loses_challenge_to_us_sugar_imperial-sugar_deal.pdf

10. Takeaways from the DOJ's UnitedHealth-Change Healthcare Merger Loss

Judge Carl J. Nichols of the United States District Court for the District of Columbia denied the request of the DOJ and two states to enjoin the proposed merger of UnitedHealth Group and Change Healthcare. Judge Nichols found that the government failed to prove that the transaction, which includes a divestiture proposed by the parties, is likely to substantially lessen competition in violation of Section 7 of the Clayton Act. The $13 billion deal was announced on January 6, 2021.

The Parties and the Transaction. UnitedHealth Group has several lines of business, including commercial health insurance and "first-pass claims editing" software, which is sold through its Optum subsidiary. First-pass claims editing is a process used by insurers to help make determinations as to whether claims should be paid. Change also operates a first-pass claims editing business, as well as an electronic data interchange (EDI) clearinghouse. As the court described, EDI clearinghouses "enable the electronic transmission of claims, remittances, and other information between and among payers [i.e., insurers] and [healthcare] providers." As such, EDI clearinghouses gain access to large amounts of claims data. The merger has both horizontal and vertical aspects: it would combine two first-pass claims editing software providers and it would combine an EDI clearinghouse (Change) with an insurer (UnitedHealth Group).

The Government's Challenge to the Transaction. The government asserted horizontal and vertical theories of harm to competition. The horizontal theory is relatively straightforward. The government argued that the merger would combine two competitors in a market for the sale of first-pass claims editing solutions, resulting in UnitedHealth having more than a 90 percent share of the market. The vertical harms asserted by the government arise from UnitedHealth gaining control over Change's EDI clearinghouse and using that control to disadvantage rival insurers. According to the government, the merger "would give [UnitedHealth] the ability and incentive to use rivals' [claims data] for its own benefit, which in turn would lessen competition in the markets for national accounts and large group commercial health insurance," and, separately, "would give [UnitedHealth] the ability and incentive to withhold innovations and raise rivals' costs to compete in those same markets for national accounts and large group plans."

The Deal Parties' "Fix-It-First" Remedy for Horizontal Concern. To address the horizontal issue, UnitedHealth agreed that it would divest Change's first-pass claims editing business (called "ClaimsXten") to TPG, a private equity firm. The government and the deal parties disagreed over the proper legal standard to use in evaluating the divestiture. The parties argued that the court should evaluate the entire series of transactions, including the divestiture, as a whole. The government, on the other hand, argued that the court should first evaluate the whole merger (including the ClaimsXten business) and then proceed to evaluate the effect of the divestiture. Because the legal analysis of mergers generally proceeds under a burden-shifting framework, the upshot is that the government's proposed standard would ultimately require the parties "to prove that there is no competitive harm" instead of requiring the government "to prove that there is substantial competitive harm."

The court ultimately agreed with the parties to the transaction that the merger and divestiture should be evaluated as a whole, but that "[i]n any event . . . the evidence leads to the same result under either standard": a conclusion "that competition in the post-divestiture market for first-pass claims editing will match, and perhaps even exceed, its current levels."

Evaluation of Private Equity Firm as Divestiture Buyer. The court determined that the divestiture of ClaimsXten to private equity firm TPG "will preserve competition in the market for first-pass claims editing." In particular, the court found that "TPG has the experience necessary to compete effectively in the claims editing market," citing testimony supporting TPG's general growth strategy, including its history of investments in R&D and pursuit of "add-on acquisitions." The court also cited testimony "that TPG earns almost all its profits by growing its businesses and then selling them for more than it paid, which aligns TPG's incentives with the performance of its investments." The court went on to find "that TPG has significant experience with 'carve-out investments,'" referencing the "successful carve-outs" of several high-profile companies. The court also found that "TPG has significant experience in the healthcare industry" and that the "evidence at trial established . . . that TPG intends to invest substantially in the ClaimsXten business." In addition, the court noted that "the scope of the divestiture package includes ClaimsXten's current senior leadership and management team—including some of the same people who elevated ClaimsXten to the top of the claims editing market."

Notably, the court rejected the government's "misplaced" argument that TPG's status as a private equity firm would cause ClaimsXten to be less competitive. To the contrary, the court found that "TPG's incentives are geared toward preserving, and even improving, ClaimsXten's competitive edge." Here, the court cited testimony from a TPG principal that TPG's return on investment would increase as the success of the company increases, and that ClaimsXten may in fact better innovate as a standalone company rather than as a "small division of a big company." Here, the court cited evidence that TPG planned to double R&D spending at the company. The court concluded that "TPG is well-positioned to maintain, and perhaps even improve upon, ClaimsXten's performance in the claims editing market."

The court also found that "the scope of the divestiture is . . . sufficient to preserve competition." Here, the court cited evidence of TPG's due diligence, through which it determined that the divestiture package will be "sufficient to operate ClaimsXten on a standalone basis," and that ClaimsXten's experienced management team "will continue to work with the business post-divestiture."

Vertical Theories. The court rejected the government's vertical theories of harm. First, the court found that the government did not satisfactorily prove that the merged company's incremental access to rival insurers' data as a result of the merger would reduce innovation in the market and therefore be likely to substantially lessen competition. After observing that UnitedHealth's Optum subsidiary already has access to much data and that the government did not offer evidence of the quantity or value of additional data Optum would gain access to, the court went on to find that "United's incentives to protect external customers' data outweigh its incentives to 'misuse' that data." Here, the court reasoned that "Optum currently pursues a multi-payer business strategy," "the success of that strategy turns on payers and providers trusting that their data will be protected," "Optum has strong incentives to preserve these relationships" and "doing so requires maintaining customers' trust that their data and [competitively sensitive information] will not fall into the hands" of UnitedHealth's insurance unit. The court also cited evidence of Optum's practice of not sharing payer data with UnitedHealth's insurance unit, citing the existence of information firewalls within UnitedHealth, provisions regarding data sharing in the company's customer contracts and the company's adherence to these firewalls and contracts. Finally, the court found that the government failed to introduce evidence from UnitedHealth's rival insurers that they would reduce innovation because of the merger.

The court went on to reject the government's theory that UnitedHealth would withhold so-called "integrated platforms" from its insurer rivals, thereby driving up their costs. (As described by the court, integrated platforms are "EDI-related innovations" that "are intended to reduce administrative waste and speed up payment to providers.") Here, the court found that integrated platforms are "'concepts,' not actual products." Regardless, according to the court, "the evidence did not establish" that UnitedHealth would be likely to withhold such products from its rivals, citing evidence that "it currently markets all of its payment integrity products to [its] biggest rivals." Ultimately, the court credited UnitedHealth executives' testimony that the company would continue to do business with other insurers over the government expert's "independent weighing of costs and benefits."

Significance. The outcome in this case is significant for several reasons.

First, the opinion sets forth a legal framework for evaluating transactions where the parties themselves propose a remedy for competitive concerns. Notably, the framework identified by the court in this case is more favorable to the deal parties than the government, ultimately requiring the government to show that even with a proposed divestiture the deal likely poses "substantial competitive harm." This is of particular significance given the Antitrust Division's current stated approach of being less amenable to settling and more willing to litigate merger cases.

Second, the court's findings with respect to the suitability of TPG (a private equity firm) as a divestiture buyer are especially notable in light of the DOJ Antitrust Division's aversion to private equity. In April, the current head of the Antitrust Division said that "too often partial divestitures ship assets to buyers like private equity firms who are incapable or uninterested in using them to their full potential." Later he said: "Very often settlement divestitures [involve] private equity firms [often] motivated by either reducing costs at a company, which will make it less competitive, or squeezing out value by concentrating [the] industry in a roll-up." These statements stand in contrast with the court's findings about the transaction at issue here. The statements also contrast with the Antitrust Division's Merger Remedies Manual, published toward the end of the prior administration and now withdrawn, which stated that "in some cases a private equity purchaser may be [a] preferred" purchaser of divestiture assets. Notably, the court favorably cited the manual's discussion of private equity several times in its opinion. The upshot is that companies divesting assets and private equity firms considering buying assets to be divested can take note of the numerous lines of evidence supporting the court's finding that the divestiture will be sufficient to preserve competition.

Third, the court's findings with respect to the government's vertical theories of competitive harm are notable both because of the government's increasing willingness to challenge vertical deals and because, with this case, the government has now lost both of the vertical merger challenges it has brought in recent years (the other being the DOJ's challenge to AT&T's acquisition of Time Warner in 2018). To be sure, several vertical deals were abandoned by the parties in the face of government challenges, but those challenges were not litigated to judgment in court.

Fourth, as is apparent throughout its opinion, the court gave great weight to evidence of the real-world conduct of the parties over the economic theories posited by the government, and to the lack of real-world evidence supporting the government's theories. For example, at one point the court observed that "the central problem with [one of the government's claims] is that it rests on speculation rather than real-world evidence that events are likely to unfold as the Government predicts" and that "antitrust theory and speculation cannot trump facts."

For the full text of our memorandum, please see:

- https://www.paulweiss.com/media/3982300/takeaways_from_the_dojs_unitedhealth_change_healthcare_merger_loss.pdf

2022 Developments (First through Third Quarters)

1. A Guide to the SEC's Proposed Climate Disclosure Requirements

On March 21, 2022, the SEC proposed significant new requirements to enhance and standardize climate-related disclosures. Registrants would be required to detail climate-related risks, risk mitigation plans and goals and oversight processes; greenhouse gas emissions; and climate-related financial metrics, as part of a new climate-related disclosures section and separate footnote to financial statements in their annual report.

Broadly speaking, the proposal focuses on three main disclosure topics: climate-related risks (including risk identification/impact, governance, oversight/risk management and mitigation), greenhouse gas emissions and climate-related financial metrics. To enhance comparability and consistency, the SEC has modeled the proposed climate disclosure framework in part on the Task Force on Climate Related Financial Disclosure and the Greenhouse Gas Protocol emissions reporting framework, as was urged by many commentators.

The proposed disclosure requirements would be set forth in proposed new Subpart 1500 of Regulation S-K and proposed new Article 14 of Regulation S-X. The proposed requirements, though providing for some materiality thresholds, include many prescriptive line items. Registrants would generally be required to present in their annual reports (or registration statements), in a separate section titled "Climate-Related Disclosure" and in a separate footnote to the financial statements, as applicable, information regarding the following:

- climate-related risks (and opportunities), including descriptions of:
    - climate-related risks and their real or likely material impacts on the company's business, strategy, outlook and financial statements;
    - the board's and management's oversight and governance of climate-related risks;
    - the company's climate-related risk management processes; and
    - climate-related risk mitigation, including the company's transition plans and targets and goals;
- GHG emissions, including:
    - Scope 1 emissions (which are direct GHG emissions from operations that are owned or controlled by a registrant);
    - Scope 2 emissions (which are indirect GHG emissions that are generated from the purchase or acquisition of electricity, steam, heat or cooling that is consumed by operations owned or controlled by a registrant);
    - if material, or if the registrant has set a GHG emissions target that includes them, Scope 3 emissions (which are all indirect GHG emissions not otherwise included in a registrant's Scope 2 emissions, which occur in the upstream and downstream activities of a registrant's value chain);
    - large accelerated filers and accelerated filers would be required to include an attestation report providing assurance on Scope 1 and Scope 2 GHG emissions from a "GHG emissions attestation provider," which must be independent and meet certain other specified requirements, but is not required to be an independent accounting firm; and
- specified climate-related financial statement metrics and related disclosures in a note to the audited financial statements.

These disclosure requirements would be phased in over time, depending on the registrant's filing status.

Companies should take stock of their current climate strategies, processes and disclosures, with an eye to evaluating what enhancements may be needed to comply with the proposed rules, if adopted. To the extent they have not yet done so, companies should consider the following questions:

- Who has oversight and responsibility for climate-related/ESG risks and opportunities?
- How is the board involved?
- What policies and procedures are in place regarding oversight and responsibility at the board and management level?
- What climate-related information is currently tracked, measured and monitored?
- What data is already being reported?
- Is this data subject to third-party verification or assurance?
- What other climate-related public statements, claims or commitments have already been made?
- How does the registrant define materiality for climate-related risk?

In particular, additional integration of climate disclosures and processes with the regular SEC and financial reporting disclosure processes may be appropriate. The SEC's proposed rules come alongside a host of similar regulations and proposals across the globe. Certain large companies in Britain and Japan were required to start disclosing their GHG emissions in 2022; the EU is set to require all large, listed companies to report their GHG emissions in 2024; and Brazil, Hong Kong, New Zealand, Singapore and Switzerland will also soon require mandatory climate risk reporting. As a result, companies should consider whether siloing of climate disclosure in a sustainability reporting function remains adequate to enable them to meet the requirements of the proposed rules, particularly in light of the added associated liability (including strict liability under the securities law for registration statements), and of the growing web of global requirements, even if the SEC does not adopt the rules as proposed.

For a more detailed guide to the proposal and its implementation timeline, please see the full text of our memorandum:

- https://www.paulweiss.com/media/3981948/a_guide_to_the_secs_proposed_climate_disclosure_requirements.pdf

2. SEC Proposes New Cybersecurity Disclosure Requirements

The SEC has proposed new disclosure requirements to enhance and standardize public company disclosures regarding cybersecurity risk management and incident reporting. The proposed amendments would require companies to disclose material cybersecurity incidents within four business days on Form 8-K, and provide any necessary updates in their subsequent periodic reports on Forms 10-Q and 10-K. The SEC is proposing similar amendments to Form 6-K requiring foreign private issuers to timely file current reports to disclose material cybersecurity incidents. In addition, companies would be required to provide annual disclosure regarding their policies and procedures to identify and manage cybersecurity risks, their board's oversight of cybersecurity risk (and the cybersecurity expertise of any members of the board) and management's role and expertise in assessing and managing cybersecurity risk and implementing cybersecurity policies and procedures.

Reporting of Material Cybersecurity Incidents

Under the proposed rules, a "cybersecurity incident" would be defined to mean "an unauthorized occurrence on or conducted through a registrant's information systems that jeopardizes the confidentiality, integrity, or availability of a registrant's information systems or any information residing therein." Should a cybersecurity incident occur, the proposed rules would require registrants to "make a materiality determination regarding a cybersecurity incident as soon as reasonably practicable after discovery of the incident." The SEC confirmed that the determination of whether a cybersecurity incident is material should be guided by the same materiality principles articulated repeatedly by the courts and the SEC—namely, whether there is a substantial likelihood that a reasonable investor would consider it important. In making this determination, the SEC reminded registrants that they need to consider the total mix of information, including both quantitative and qualitative factors, and that an incident may be material even if the probability of a negative consequence is low, if the potential loss or liability is large. Materiality must be assessed on an incident-by-incident basis, as well as on an aggregate basis, to determine whether a series of minor incidents has become material in the aggregate and must be disclosed in the registrant's periodic reports.

Proposed amendments to Form 8-K add a new Item 1.05, requiring registrants to disclose, within four business days of their determination that a material cybersecurity incident has occurred, the following information (to the extent known at the time of the filing):

- when the incident was discovered and whether it is ongoing;
- a brief description of the nature and scope of the incident;
- whether any data was stolen, altered, accessed or used for any other unauthorized purpose;
- the effect of the incident on the registrant's operations; and
- whether the registrant has remediated or is currently remediating the incident.

Registrants would not be required or expected to publicly disclose specific, technical information about their planned responses to the incident or their cybersecurity systems, related networks and devices or potential system vulnerabilities at a level of detail that could hamper their ability to respond to or remedy the incident.

Under the proposed rules, foreign private issuers would need to make similar disclosures regarding cybersecurity incidents. The SEC has proposed amending Form 6-K to identify material cybersecurity incidents as a filing trigger. Material updates regarding previously disclosed incidents would also need to be provided on Form 6-K. In addition, the SEC has proposed amendments to Form 20-F that would require foreign private issuers to disclose on an annual basis information regarding any previously undisclosed material cybersecurity incidents that have occurred during the reporting period. The SEC is not proposing any changes to Form 40-F.

Disclosure of Risk Management, Strategy and Governance Regarding Cybersecurity Risks
In order to elicit more consistent and informative disclosure, the SEC has proposed new Item 106 of Regulation S-K, which would require registrants to describe in their Annual Reports on Form 10-K their risk management and strategy, as well as the role of their boards and management in overseeing, assessing and managing these risks. The SEC has proposed amending Form 20-F to require similar disclosures by foreign private issuers. The SEC is not proposing any such changes to Form 40-F.

For the full text of our memorandum, please see:

- https://www.paulweiss.com/media/3981833/sec_proposes_new_cybersecurity_disclosure_requirements.pdf

For the SEC proposal, please see:

- https://www.sec.gov/rules/proposed/2022/33-11038.pdf

3. SEC Finalizes Pay-for-Performance Rules
The SEC has finalized its pay-for-performance disclosure rules, largely as proposed. These rules implement Section 14(i) of the Exchange Act, as added by Section 953(a) of the Dodd-Frank Act. Section 14(i) directs the SEC to adopt rules requiring reporting

companies to disclose in a clear manner the relationship between executive compensation actually paid and the financial performance of the company.

These new pay-for-performance rules require reporting companies to disclose in their proxy and information statements a new standardized figure for compensation "actually paid" (that is, total compensation otherwise reported in the proxy with the adjustments to pension and equity award methodologies) to the principal executive officer and to the remaining named executive officers; tabular disclosure of certain performance measures, including absolute and relative total shareholder return and net income; and a description of the relationship between the performance measures and compensation. Disclosure is required for the last five fiscal years, subject to a transition period.

These requirements apply to all reporting companies, except foreign private issuers, registered investment companies and emerging growth companies. Smaller reporting companies are subject to scaled reporting requirements.

The rules became effective on October 11, 2022, and the new disclosure is now required in proxy and information statements disclosing compensation for fiscal years ending on or after December 16, 2022.

For the full text of our memorandum, please see:

- https://www.paulweiss.com/media/3982230/sec_finalizes_pay_for_performance_rules.pdf

For the SEC final rules, please see:

- https://www.sec.gov/rules/final/2022/34-95607.pdf

4. SEC Proposes Significant Updates to Schedule 13D/G Reporting

The SEC has proposed long-awaited amendments to modernize Schedule 13D and 13G beneficial ownership reporting. If implemented, these changes would significantly enhance disclosure around block holdings, including by activist hedge funds. Among other things, the proposed amendments would:

- accelerate deadlines for publicly filing Schedules 13D and 13G;
- expand beneficial ownership to include cash-settled swaps acquired with a control intent; and
- address "wolf-pack" behavior by clearly defining "groups" to include those acting together (even without an agreement to do so) and tippees to a Schedule 13D filing.

The new disclosure regime could have a significant impact on some activist campaigns. Activist hedge funds often seek to acquire a significant number of shares during the "interim period" between crossing the 5% threshold and publicly filing a Schedule 13D—at which point the public company's stock price may increase as a result of the activist's investment, making subsequent share acquisitions more expensive. In addition, the public company's board of directors may adopt a shareholder rights plan at the time of the activist's Schedule 13D filing.

For the full text of our memorandum, please see:

- https://www.paulweiss.com/media/3981766/sec_proposes_significant_updates_to_schedule_13dg_reporting.pdf

For the SEC proposal, please see:

- https://www.sec.gov/rules/proposed/2022/33-11030.pdf

5. SEC Proposes to Narrow Exclusions under Rule 14a-8

On July 13, 2022, the SEC proposed amendments to Rule 14a-8, which would narrow the circumstances under which companies may exclude shareholder proposals on the grounds that they are "substantially implemented," "substantially duplicate" another proposal or are a resubmission that did not meet specified approval rates in prior years. These grounds for exclusion represent a significant proportion of Rule 14a-8 no-action requests, and many shareholder proposals that would have been excludable under current practice would no longer be under the proposed amendments. This proposal is the most recent move by the SEC to limit exclusion of shareholder proposals, following Staff Legal Bulletin 14L and other policy changes. If adopted, the practical implication is that more shareholder proposals will be included in proxy materials, and companies will have to appeal directly to shareholders regarding their suitability either in the company statement of opposition or via engagement.

Substantially Implemented. Under Rule 14a-8(i)(10), a company may exclude a proposal that has been "substantially implemented." The amendments would provide that a company has substantially implemented a proposal only if the company has already "implemented the essential elements of the proposal." This would involve a factual analysis to identify the essential elements of the proposal and whether they have been addressed. All essential elements would need to be implemented in order to exclude the proposal. The SEC identified examples highlighting the strict focus on the implementation of the "essential element" requirement, which reflect changes to the Staff's historical practice:

- A proxy access proposal requesting to allow an unlimited number of shareholders who collectively own 3% of the company's outstanding common stock for three years to nominate up to 25% of the company's directors would not be excludable where the company already has a proxy access provision that allows a group of up to 20 shareholders meeting those ownership thresholds to nominate up to 20% of the board because the essential element of the proposal is that the group be an unlimited number of shareholders.

- A proposal requesting a report from the company's board of directors, where management already delivers such a report, would not be excludable if the proposal emphasizes reporting from the board and thus an essential element is the involvement of the board (rather than management).

The SEC noted, however, that the more objectives, elements or features a proposal identifies, the more likely that the Staff would view each of them as less essential.

Substantially Duplicates. Under Rule 14a-8(i)(11), a company may exclude a proposal that "substantially duplicates" another proposal that has been submitted for the same meeting. The amendments would provide that a proposal "substantially duplicates" another proposal if it "addresses the same subject matter and seeks the same objective by the same means as" the other proposal. These proposed changes would also require an analysis of the objectives and means of the proposals and where they differ (even though addressing the same subject matter), would not permit exclusion of subsequent proposals.

Resubmission. Under Rule 14a-8(i)(12), a company may exclude a proposal that addresses "substantially the same subject matter" as a previous proposal that failed to meet required voting thresholds. The amendments would incorporate the "substantially duplicates" standard in Rule 14a-8(i)(11) above. As a result, proposals would only be excludable under Rule 14a-8(i)(12) if they address the same subject matter and seek the same objective by the same means as a prior proposal.

For the full text of our memorandum, please see:

- https://www.paulweiss.com/media/3982121/sec_proposes_to_narrow_exclusions_under_rule_14a_8.pdf

For the SEC final rules, please see:

- https://www.sec.gov/rules/final/2022/34-95266.pdf

6. SEC Proposes Shortening Securities Settlement Cycle to T+1

The SEC has proposed new rules that would shorten the securities settlement cycle to T+1. In order to facilitate this, the SEC has proposed additional new rules that would require brokers and dealers complete allocations, confirmations, affirmations or any combination thereof, on a same-day basis and for investment advisers to make and keep records of confirmations received and allocations and affirmations sent, and would require central matching service providers to adopt policies and procedures to facilitate straight-through processing. If adopted as proposed, the rules would require T+1 settlement by March 31, 2024. In addition, the SEC in its proposing release noted its objective of reaching T+0 settlement and has invited comment on how to eventually achieve that goal.

For the full text of our memorandum, please see:

- https://www.paulweiss.com/media/3981772/sec_proposes_shortening_securities_settlement_cycle_to_t1.pdf

For the SEC proposal, please see:

- https://www.sec.gov/rules/proposed/2022/34-94196.pdf?utm_medium=email&utm_source=govdelivery

7. SEC Proposes New SPAC Rules

The SEC has proposed significant new rules that, if adopted, could have a profound impact on SPACs. Fundamentally, the proposed rules aim to treat de-SPAC transactions more like traditional IPOs. In an effort to promote accountability, the proposed new rules would impose new liabilities in connection with de-SPAC transactions, including on SPAC underwriters and de-SPAC targets and their management. In addition, the SEC proposal would modify the scope of the safe harbor of the Private Securities Litigation Reform Act of 1995 ("PSLRA") for forward-looking statements so that projections and other forward-looking information used in de-SPAC registration statements would not be eligible for safe harbor protections conventionally given to such disclosure outside of the traditional IPO context. The proposed rules include a number of disclosure enhancements at the SPAC IPO and de-SPAC stages, and most notably would require a fairness determination by the SPAC regarding the de-SPAC transaction. The proposed rules also wade into the debate over the status of SPACs as investment companies, and propose a new, non-exclusive safe harbor for SPACs that would accelerate most SPAC timelines. Taken together, the new rules, if enacted, would effectuate recent promises by senior SEC officials to more closely scrutinize, and exercise stricter oversight over, the SPAC market. Notwithstanding that some of the proposed changes (e.g., some of the disclosure proposals) have already been adopted by market participants as best practices, other parts of the proposals (such as underwriter status for financial advisors in the de-SPAC process) would represent significant changes.

De-SPAC Underwriter and Target Liability. The SEC has proposed new Rule 140a, which would deem any SPAC IPO underwriter who facilitates the de-SPAC transaction or related financing, or otherwise participates in the de-SPAC transaction, to be an underwriter in the distribution of securities constituting the de-SPAC transaction. The receipt of compensation in connection with the de-SPAC transaction, including receipt of deferred SPAC IPO underwriting fees, acting as a financial advisor to the SPAC and otherwise engaging in activities necessary to the de-SPAC transaction would all be considered "participation" in the distribution, and would be subject to traditional underwriter liability under the federal securities laws. Similarly, the SEC has proposed amending Forms S-4 and F-4 to require that both the SPAC and the target company be treated as co-registrants. As a result, the target company, its principal executive officer, its principal financial officer, its controller/principal accounting officer and a majority of its board of directors would be required to sign the registration statement and be subject to liability for any material misstatements or omissions in the registration statement.

Projections. The proposed rules would eliminate the availability to SPACs and other blank check companies of the PSLRA safe harbor with respect to forward-looking statements. Thus, de-SPAC transactions would be treated like traditional IPOs. To improve the presentation of projections, the SEC has also proposed additional disclosure requirements for projections via amendments to Item 10(b) of Regulation S-K and new Item 1609 of Regulation S-K.

Target Disclosures. To better synchronize de-SPAC and traditional IPO disclosures, the proposed rules would (i) require certain non-financial Regulation S-K disclosures of targets in de-SPAC business combination filings, instead of in the post-closing "Super 8-K," so that SPAC investors would be able to review and consider the disclosure prior to making any voting or investment decision and, to the extent that information is included in a registration statement on Forms S-4 or F-4, subject such information to liability under the Securities Act of 1933, as amended, and (ii) codify existing SEC guidance regarding financial statements in business combinations involving shell companies.

SPAC Disclosures. The proposed rules would create a new Subpart 1600 of Regulation S-K, setting forth specific disclosure requirements for SPAC IPOs and de-SPAC transactions. Notably, in the de-SPAC business combination filings, the SPAC would have to make a statement about the fairness of the de-SPAC transaction and any related financing to unaffiliated security holders and discuss the material factors upon which a reasonable belief regarding the fairness of a de-SPAC transaction and any related financing transaction is based and, to the extent practicable, the weight assigned to each such factor. These factors would include: the valuation of the private operating company; the consideration of any financial projections; any report, opinion or appraisal obtained from a third party; and the dilutive effects of the de-SPAC transaction and any related financing transaction on non-redeeming shareholders.

Smaller-Reporting Company Status. Post de-SPAC companies would be required to reevaluate their smaller-reporting company status within four days following the consummation of a de-SPAC transaction (instead of retaining this status until its next annual report).

Investment Company Act. The SEC has proposed a new, non-exclusive safe harbor for SPACs under the Investment Company Act of 1940. While most of the conditions of this safe harbor will be easily met by SPACs, the safe harbor would impose an accelerated de-SPAC time frame: SPACs would be required to enter into an acquisition agreement with a target within 18 months of the SPAC IPO, and to close the transaction within 24 months. Currently, many SPACs initially have up to 24 months to enter into and consummate an acquisition, and may extend this period via a shareholder vote. As currently drafted, these deadlines would not be subject to extension.

For the full text of our memorandum, please see:

- https://www.paulweiss.com/media/3981887/sec_proposes_new_spac_rules.pdf

For the SEC proposal, please see:

- https://www.sec.gov/rules/proposed/2022/33-11048.pdf

* * *

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
+1-212-373-3434
ccummings@paulweiss.com

Adam M. Givertz
+1-212-373-3224
agivertz@paulweiss.com

Ian M. Hazlett
+1-416-504-0518
ihazlett@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

Associate Ben Mayer-Goodman and Law Clerk Daniel J. Korman contributed to this Client Memorandum.