Paul | Weiss

CLIENT MEMORANDUM

April 18, 2022

Q1 2022 U.S. Legal & Regulatory Developments

The following is our summary of significant U.S. legal and regulatory developments during the first quarter of 2022 of interest to Canadian companies and their advisors.

1. SEC Proposes New Climate Disclosure Requirements

On March 21, 2022, the United States Securities and Exchange Commission (the "SEC") proposed significant new disclosure requirements to enhance and standardize disclosures regarding climate-related risks. Unlike existing climate and environmental, social, and corporate governance disclosure requirements, which have largely been principles-based, the new proposal, while still including materiality thresholds, also includes more prescriptive, line-item requirements. The SEC has modeled its climate disclosure framework proposal in part on the U.K.'s Task Force on Climate-Related Financial Disclosure and the Greenhouse Gas Protocol emissions reporting framework, as was urged by many commentators. These proposed rules are the culmination of a year-long process of inquiry and public input, which has already seen over 600 unique comment letters submitted to the SEC.

These proposed requirements would apply to domestic registrants as well as foreign private issuers filing on Form 20-F. However, the SEC is not proposing any such changes to Form 40-F. The SEC is also proposing a multi-year phase-in for the disclosure requirements based on company filing status.

Comments to this proposal are due May 20, 2022, and we expect there will be a significant number of comments from many constituencies.

For the full text of our memorandum, please see:

- https://www.paulweiss.com/media/3981862/sec_proposes_new_climate_disclosure_requirements.pdf

For the SEC proposal, please see:

- https://www.sec.gov/rules/proposed/2022/33-11042.pdf

2. SEC Proposes New SPAC Rules

The SEC has proposed significant new rules that, if adopted, could have a profound impact on special purpose acquisition companies ("SPACs"). Fundamentally, the proposed rules aim to treat de-SPAC transactions more like traditional initial public offerings ("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. Comments on the proposal will be due by the later of (i) May 31, 2022, and (ii) 30 days after its publication in the Federal Register and we expect there will be a significant number of comments.

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 re-evaluate 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

3. 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 Form 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

4. 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

5. Delaware Court of Chancery Enforces Unambiguous Terms of Advance Notice Bylaw

In *Strategic Investment Opportunities LLC v. Lee Enterprises, Inc.*, the Delaware Court of Chancery upheld a board's rejection of a stockholder nomination notice due to noncompliance with the unambiguous terms of the corporation's advance notice bylaw relating to stockholder nomination of directors – namely, that the notice must be submitted by a record holder and that information regarding the nominees must be submitted on a form provided by the company. This recent opinion by Vice Chancellor Will, viewed alongside *Rosenbaum v. CytoDyn, Inc.* (another recent decision upholding the rejection of stockholder nominees due to deficiencies in the stockholder notice required by a company's advance notice bylaws), indicates that the Delaware courts can be expected to continue to enforce the terms of advance notice bylaws that are adopted on a "clear day" and where there is no evidence of manipulation or other inequitable conduct by the board.

On the date of the deadline for nominations under the advance notice bylaw of Lee Enterprises, Inc. ("Lee"), Strategic Investment Opportunities ("Opportunities"), a beneficial owner of Lee stock and the vehicle of a hedge fund that was concurrently making a bid for Lee, submitted a notice nominating directors for Lee's upcoming annual stockholder meeting. Recognizing that it was not a record holder of Lee shares as required under the bylaws for submission of a valid nomination notice, Opportunities had attempted, but failed, to move some of its shares to record holder status before the nomination deadline. To bridge this shortcoming, Opportunities included a "cover letter" from the record holder of its shares, Cede & Co., alongside its notice, but the Cede letter did not include any information about the Opportunities nominees and referred to the nomination as one by Opportunities, not Cede.

In addition, Opportunities' own notice did not use Lee's form of nominee questionnaire, again, as required under the bylaws. Opportunities had requested the form from Lee a few days before the submission of its nomination notice, but Lee denied the request, noting that it was only required to provide the form to stockholders of record. In lieu of Lee's form, Opportunities submitted questionnaires for its nominees that were "substantially similar in scope to the forms of written questionnaires provided by a company's secretary in like situations" alongside its nomination notice.

Six days after the nomination deadline, Lee rejected Opportunities' nomination notice. Opportunities filed suit in the Court of Chancery alleging breach of contract and breach of fiduciary duty by Lee's board of directors and seeking a declaration that Opportunities nominees were permitted to stand for election at the 2022 Lee annual meeting of stockholders, among other relief.

The court concluded that the Lee board did not improperly reject the nomination notice and denied Opportunities' requested relief. The key takeaway from this and the *Rosenbaum* decision is that Delaware courts will enforce the unambiguous terms of a reasonable advance notice bylaw, adopted on a "clear day" and absent evidence that the board's actions were unreasonable or inequitable. Applying enhanced scrutiny to the board's rejection of the Opportunities' nomination notice (which requires the directors to identify the proper corporate objectives served by their actions and justify their actions as reasonable in relation to those objectives), the court looked to three key questions in its inquiry: whether the bylaws were clear and unambiguous (with any ambiguity to be resolved in favor of stockholders' electoral rights), whether the stockholder's nominations complied with the bylaws and whether the company interfered with the plaintiff's attempt to comply. Finding that the answer to each was no, the court denied plaintiff's relief.

While equity would prevent the use of advance notice bylaws to obstruct "legitimate efforts of dissident stockholders to undertake a proxy fight," the court also noted that these bylaws help ensure orderly meetings and election contests. With respect to the situation at hand, the court stated that the record holder requirement in Lee's bylaws was "not an empty formalism" and provided the nominating party with "skin in the game"; and that the board's enforcement of Lee's advance notice bylaws was "reasonable and appropriate." Importantly, the court noted that it was actually Opportunities' delay that prevented it from satisfying Lee's advance notice requirements. Based on these decisions, companies should consider reviewing their advance notice bylaws on such a "clear day" to ensure that they conform to modern market practices.

For the full text of our memorandum, please see:

- https://www.paulweiss.com/media/3981787/delaware_court_of_chancery_enforces_unambiguous_terms_of_advance_notice_bylaw.pdf

For the Delaware Court of Chancery's opinion in *Strategic Investment Opportunities LLC v. Lee Enterprises, Inc.*, please see:

- https://courts.delaware.gov/Opinions/Download.aspx?id=329770

For our memorandum on *Rosenbaum v. CytoDyn, Inc.*, please see:

- https://www.paulweiss.com/media/3981478/stockholder_nominees_barred_for_noncompliance_with_clear-day_advance_notice_bylaw.pdf

6. 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 bloc 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

7. Acting SEC Chief Accountant Issues Statement Regarding Assessing Materiality of Financial Statement Errors

The SEC's acting Chief Accountant issued a statement addressing the assessment of the materiality of financial statement errors, and described a number of scenarios encountered by the SEC's Office of Chief Accountant ("OCA"), in addition to emphasizing other important considerations during the materiality assessments.

Materiality: The determination of the materiality of a financial statement error will impact the corrective actions a registrant must take. Where an error is material to previously-issued financial statements, it must be corrected by restating and reissuing the prior period financial statements (a "Big R" restatement, or reissuance statement). Where the error is not material to previously-issued financial statements, but correcting the error, or leaving it uncorrected, would be material to current period financial statements, the registrant may correct the error in the current period financial statements (a "little r" restatement, or revision restatement). The OCA has noted that "little r" restatements have significantly increased as a proportion of restatements in recent years, from approximately 35% in 2005, to approximately 76% in 2020. While acknowledging that this may be due to audit and internal control improvements, the OCA is monitoring this trend.

Objectivity: The materiality of an accounting error should be assessed from the perspective of a reasonable investor, and must be objective, considering all relevant facts and circumstances, including quantitative and qualitative factors. To be objective, the analysis must avoid any bias on the part of the registrant, its auditor or audit committee that would be inconsistent with such a perspective – for example, concern about the negative impact on executive compensation as a result of clawbacks, reputational harm to the registrant, a decrease in the registrant's share price, increased scrutiny by investors or regulators, or litigation. Allowing such impacts to influence a materiality assessment would not be objective and thus not consistent with the concept of materiality.

Qualitative Factors: Assessment of qualitative factors: Staff Accounting Bulletin 99 contemplates that quantitatively small errors may be considered material as a result of qualitative factors. The converse, that quantitatively significant errors are immaterial as a result of qualitative considerations, is an unlikely outcome – as the OCA noted, "as the quantitative magnitude of the error increases, it becomes increasingly difficult for qualitative factors to overcome the quantitative significance of the error." Registrants should also consider the qualitative factors they are using in their materiality assessment – the qualitative factors that may be relevant in the assessment of materiality of a quantitatively significant error would not necessarily be the same qualitative factors noted in SAB No. 99 when considering whether a quantitatively small error is material.

Usefulness of Information: The lack of usefulness of certain information required to be presented under the generally accepted accounting principles ("U.S. GAAP") or International Financial Reporting Standards ("IFRS") does not render an error immaterial. Because audited financial statements must be prepared in accordance with U.S. GAAP or IFRS, and the importance of the comparability of financial statements to investors' ability to identify and understand trends over time, "financial statements prepared in accordance with U.S. GAAP or IFRS, as required by Commission rules, [are] the starting point for any objective materiality analysis."

Non-GAAP Measures: Registrants should also consider the impact of errors on key non-GAAP measures as part of their materiality analysis.

Intention and Common Errors: While intentionality may contribute to a finding that an error is material, the lack of intentional misstatement is not evidence that the error is not material. This argument is often made in the case where other registrants have made a similar error (reflecting a "widely held view" rather than an intentional error).

Aggregation: The analysis of the aggregate effects of multiple errors should not serve as the basis for a conclusion that individual errors are immaterial. Each error or misstatement must first be evaluated individually to determine whether it is material. The aggregated effects of immaterial errors should then also be considered to determine whether an immaterial error, together with other misstatements, renders the financial statements taken as a whole materially misleading.

Internal Control over Financial Reporting: Objectivity is also important to the assessment of the effectiveness of internal control over financial reporting ("ICFR"). While the existence of a material accounting error is an indicator of the existence of a material weakness, a material weakness may also exist without the existence of a material error. As part of its ICFR effectiveness assessment, management must consider not just the error but also the magnitude of the potential misstatement that could result. Management's ICFR effectiveness assessment should be a holistic, objective analysis of the potential impact and severity of a deficiency. The OCA urged additional focus on the adequacy of and basis for registrants' ICFR effectiveness assessments, especially when considering whether deficiencies are significant deficiencies (that must be reported to the audit committee) or a material weakness (that must be publicly disclosed).

Auditor Policies: Because of the vital role of auditors in assessing the materiality of financial statement errors, auditors should consider their quality control systems to ensure that they are adequately designed to ensure that its professionals comply with applicable professional standards.

For the full text of our memorandum, please see:

- https://www.paulweiss.com/media/3981870/acting_sec_chief_accountant_issues_statement_regarding_assessing_materiality_of_financial_statement_errors.pdf

For the SEC's acting Chief Accountant's statement, please see:

- https://www.sec.gov/news/statement/munter-statement-assessing-materiality-030922?utm_medium=email&utm_source=govdelivery

8. SEC Reopens Comment Period for Pay for Performance Proposal

The SEC reopened the comment period for its 2015 pay for performance proposal. The proposal would implement Section 14(i) of the Securities Exchange Act of 1934 (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.

Under the proposal, reporting companies would be required to disclose in their proxy and information statements standardized figures for compensation "actually paid" to the principal executive officer, the average compensation "actually paid" to the remaining named executive officers, and certain performances measures, including the company's total shareholder return and total shareholder return for a peer group of companies and the relationship between the performance measures and compensation. Disclosure would be required for the last five fiscal years subject to a transition period. These requirements would apply to all reporting companies, except foreign private issuers, registered investment companies and emerging growth companies. Smaller reporting companies would be subject to scaled reporting requirements.

For the full text of our memorandum, please see:

- https://www.paulweiss.com/media/3981739/sec_reopens_comment_period_for_pay_for_performance_proposal.pdf

For the SEC's 2015 proposal, please see:

- https://www.sec.gov/rules/proposed/2015/34-74835.pdf

For the SEC release reopening the comment period, please see:

- https://www.sec.gov/rules/proposed/2022/34-94074.pdf

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

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