Katten

Capital Markets Compass

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Editorial Note

This issue of the *Compass* focuses on the latest developments in the world of climate change and capital markets. We cover the SEC's proposed disclosure rules and recent SEC comment letter trends. You will also see a summary of 2022 ESG considerations provided by Farzad Damania, a partner in Katten's Capital Markets practice. If you have any questions about the *Compass* or any articles in this issue (or would like a particular topic to be covered in our next issue), please reach out to your Katten contact or to any of the Capital Markets partners listed on the last page of the newsletter. Thank you and we hope you are well!

Timothy J. Kirby and Jennifer L. Howard

In This Issue

SEC's Climate-Related Comment Letters – Avoiding Potential Pitfalls

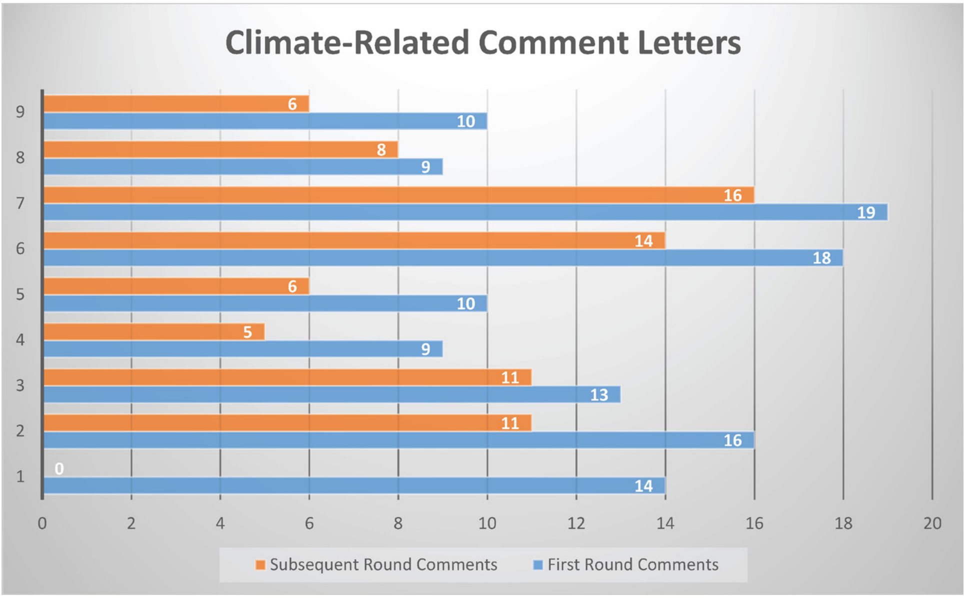
By Farzad F. Damania, Jennifer L. Howard and Ryan A. Lilley

In September 2021, the Securities and Exchange Commission (SEC) provided a sample comment letter that included nine potential climate-related comments the SEC may issue to companies regarding their climate-related disclosure or the absence of such disclosure. The SEC has recently started to release the comment letters and responses. We have reviewed the climate-related comment letters not related to a securities offering through April 24 and summarized our findings below. It appears the SEC initially focused on providing comment letters to larger companies, with 25 companies ranging from $3.7 billion to $1.5 trillion in market capitalization spanning a broad range of industries. Companies received an average of 4.7 first-round comments and 3.1 second-round comments. While less common, certain companies received third-round comments.

Sample Comments and Company Responses

1. "We note that you provided more expansive disclosure in your corporate social responsibility report (CSR report) than you provided in your SEC filings. Please advise us what consideration you gave to providing the same type of climate-related disclosure in your SEC filings as you provided in your CSR report."

The SEC requested information regarding the consideration companies gave to including more expansive information in their CSR reports than in their SEC filings. Responses to this comment generally noted that the companies are following different disclosure requirements for CSR reports and SEC filings and contain confirmations that the companies will continue to monitor and evaluate whether to include additional climate-related information in future SEC filings. There has been no pushback from the SEC to company responses.



The table indicates frequency of comments issued and subsequent-round comments issued by the SEC for each of the nine sample comments.

2. "Disclose the material effects of transition risks related to climate change that may affect your business, financial condition, and results of operations, such as policy and regulatory changes that could impose operational and compliance burdens, market trends that may alter business opportunities, credit risks, or technological changes."

The SEC requested information regarding the transition risks related to climate disclosure that may affect a company's business. Initial responses that respectfully denied the potential climate change impact on the company's business or that stated no material effects have been identified received additional comments from the SEC. Four companies did not receive such additional requests and each of the companies that avoided multiple rounds of comments acknowledged the potential impact of transition risks on their businesses.

In response to subsequent-round comments from the SEC, most companies provided greater detail as to what they consider to be transition risks and how their materiality determinations were made. For example, one company stated that it considers transition risks related to climate change to include "potential policy and regulatory changes, technology changes, market trends, stakeholder views and credit risks." This company also stated that it considers materiality as the "substantial likelihood that the information, including transition and other risks, would have been viewed by the reasonable investor as having significantly altered the total mix of information made available." The company then provided a detailed analysis of the materiality of certain transition risks facing the company and concluded that such transition risks have not yet been material to the company.

While there is no sure way to avoid multiple rounds of comments from the SEC, companies should consider defining transition risks and materiality and providing a detailed analysis that supports their conclusions regarding materiality.

3. "There have been significant developments in federal and state legislation and regulation and international accords regarding climate change that you have not discussed in your filing. Disclose any material litigation risks related to climate change and explain the potential impact to the company."

The SEC requested information related to material, climate-related litigation risks and their potential impact to certain companies. Companies that denied awareness of any material, climate-related risks in their initial responses received additional comments from the SEC.

In responding to second- or third-round comments, companies provided greater detail on how they came to their materiality determination. In particular, certain companies defined material litigation and cited the materiality requirement in Item 105 of Regulation S-K. For example, one company stated that material lawsuits are those that involve amount greater than or equal to 1 percent of its consolidated profits before income taxes and stated that there have been no climate-related lawsuits based on this measurement. Additionally, this company provided a description of the considerations that the company took into account when making its materiality determination, including the likelihood of climate-related lawsuits alleging contribution to climate change in relation to their compliance with environmental laws and the prevalence of such lawsuits currently and historically.

Companies may be able to avoid subsequent rounds of comments from the SEC by providing detail as to what they consider material litigation risks, their processes for identifying material litigation risks and citing SEC guidance on materiality in explaining their decision whether to disclose such risks in the SEC filings.

4. "Please revise your disclosure to identify material pending or existing climate change-related legislation, regulations, and international accords and describe any material effect on your business, financial condition, and results of operations."

Some companies received comment letters requesting disclosure regarding the impact of climate-related developments in federal and state legislation and regulation and international accords. Companies took varying approaches to this comment. Some

made broad statements noting that while there have been developments in legislation, regulation, and international accords, no developments have occurred that would be considered material and necessitate such disclosure in the company's SEC filings. Other companies identified specific facts, such as the company's alignment with the Paris Agreement and strategies implemented to reach the company's goals. A little over half of the companies responding to this comment drew requests for additional information from the SEC. A mere commitment to environmental sustainability was not enough on its own to avoid subsequent follow-up from the SEC on this comment.

Companies responding to multiple rounds of comments described their processes for identifying climate change-related legislation, regulations, or international accords that could materially impact their businesses, along with the related factors such companies consider for materiality determinations related to climate change-related legislation, regulations, or international accords.

To avoid receiving subsequent rounds of comments, companies should consider getting ahead with their climate disclosures by including risk disclosures that specifically reference the potential for legislative and regulatory changes to impact their businesses, financial condition and results of operations.

5. "Revise your disclosure to identify any material past and/or future capital expenditures for climate-related projects. If material, please quantify these expenditures."

The SEC issued comment letters requesting disclosure of any material past and/or future capital expenditures for climate-related projects. Companies that responded to this comment by providing all expenses related to environmental compliance or those expenses that had a positive effect on the environment in their first response avoided second round comments from the SEC. About half of the companies did not provide any support for their conclusion that their businesses did not have any material climate-related capital expenses and received additional comments from the SEC.

To avoid additional rounds of comments from the SEC, companies should consider providing details regarding capital expenditures on projects related to environmental sustainability. Projects that involve new, energy-efficient facilities or pursuing certifications such as the LEED Gold certification, if any, should be included in companies' initial responses. Companies should also consider including the percentage amount of climate-related capital expenditures relative to their consolidated capital expenditures when explaining their determination of materiality for such expenditures.

6. "To the extent material, discuss the indirect consequences of climate-related regulation or business trends, such as the following:

- *decreased demand for goods or services that produce significant greenhouse gas emissions or are related to carbon-based energy sources;*
- *increased demand for goods that result in lower emissions than competing products;*
- *increased competition to develop innovative new products that result in lower emissions;*
- *increased demand for generation and transmission of energy from alternative energy sources; and*
- *any anticipated reputational risks resulting from operations or products that produce material greenhouse gas emissions."*

The SEC issued comments related to the indirect consequences of climate-related regulation or business trends such as increased or decreased demand based on a product's carbon footprint. Most companies responded by noting that they had not identified any material indirect consequences of climate-related regulation or business trends that had a material impact on their businesses. However, simply including this statement was not sufficient, and nearly all companies received a second round of comments with a request for more information from the SEC.

Companies responding to subsequent rounds of comments provided detailed support for their determination of materiality, and some also provided metrics such as the percentage of weather-related damages to their property relative to their selling, general and administrative expenses.

To avoid similar SEC comments, companies should consider including disclosure regarding the indirect effects of climate-related regulation and business trends on their businesses in their SEC filings. If companies receive similar SEC comments, they should consider providing detailed support for their materiality determination in their responses to avoid additional comments.

7. "If material, discuss the physical effects of climate change on your operations and results. This disclosure may include the following:

- *severity of weather, such as floods, hurricanes, sea levels, arability of farmland, extreme fires, and water availability and quality;*
- *quantification of material weather-related damages to your property or operations;*
- *potential for indirect weather-related impacts that have affected or may affect your major customers or suppliers;*
- *decreased agricultural production capacity in areas affected by drought or other weather-related changes; and*
- *any weather-related impacts on the cost or availability of insurance."*

The SEC issued company-specific comments regarding the physical effects of climate change on operations such as severity of weather, material weather-related damages, decreased agricultural production, etc. Many companies denied the existence of any significant physical effects of climate change on their businesses and the SEC was quick to reissue comments for responses that it viewed as conclusory.

Companies responding to subsequent rounds of comments for information noted the weather-related damages that they experienced in years past relative to total costs and expenses.

To avoid multiple rounds of comments from the SEC, companies should consider acknowledging the potential impact of the physical effects of climate change and consider providing their costs specifically related to damages from extreme weather.

8. "Quantify any material increased compliance costs related to climate change."

The SEC has issued a few comments relating to climate change-related compliance costs. Most companies stated that they did not incur any material climate change-related compliance costs in their initial response. However, many companies received second-round comments and provided data to support their materiality determination. For example, one company noted that its climate change compliance costs have been less than 0.1 percent of its total selling, general and administrative expenses for its last three fiscal years.

To avoid receiving multiple rounds of comments from the SEC for this comment, companies should consider providing detailed descriptions of their processes for determining the materiality of climate-related compliance costs. Additionally, companies that determine such costs are immaterial should consider providing a percentage representation of their climate-related compliance costs relative to certain selling, general and administrative costs or other expense measures.

9. "If material, provide disclosure about your purchase or sale of carbon credits or offsets and any material effects on your business, financial condition, and results of operations."

The SEC issued a few comments relating to the purchase and sale of carbon credits or offsets. In their initial responses, many companies stated that their purchase or sale of carbon credits or offsets were not material to their business. If companies failed to provide any support for this conclusion, the SEC issued subsequent rounds of comments for additional information.

To avoid receiving multiple rounds of SEC comments, companies that purchase and sell carbon credits or offsets should consider providing the amount of carbon credits or offsets purchased or sold. Companies that do not purchase carbon credits or offsets could consider stating that they do not purchase or sell carbon offsets or credits.

Going Forward

In light of the SEC's proposed climate-change disclosure rules (See "SEC Proposes Climate-Related Disclosure Requirements."), we anticipate that the SEC will continue to issue comment letters similar to the comments discussed above. To avoid multiple rounds of comment letters from the SEC, companies should review their disclosures in light of the SEC's focus areas and consider providing as much detail as they can. While there is no sure-fire way to ensure that the SEC will not re-issue comments or issue a second or even third round of comments, there are steps companies can consider taking to reduce their securities compliance costs related to these climate-change comment letters, including the following:

- Gather company-specific climate change data;
- Carefully consider the risks and potential financial and operational impact of climate change;
- Disclose such data and climate-related risks in periodic SEC filings; and
- Provide details for the basis of company decisions related to materiality.

While companies may follow each of these steps and still receive multiple comment rounds from the SEC, companies following these steps may be less likely to receive such comments and will be in a better position to adequately respond to the SEC in their initial responses.

SEC Proposes Climate-Related Disclosure Requirements

By Farzad F. Damania, Jennifer L. Howard and Ryan A. Lilley

On March 21, the Securities and Exchange Commission (SEC) proposed rule changes that would require registrants to include certain climate-related disclosure in their registration statements and periodic reports. The proposed rule would require companies to disclose information regarding climate-related risks that are reasonably likely to have a material impact on their businesses, results of operations, or financial conditions. Additionally, companies would be required to disclose their greenhouse gas emissions (GHG Emissions) and to include certain climate-related metrics in their financial statements. SEC Chair Gary Gensler stated that this proposal would "provide investors with consistent, comparable, and decision-useful information for making their investment decisions, and it would provide consistent and clear reporting obligations for issuers." The proposed rules, described in brief below, are based in part on guidance from the Task Force on Climate-related Financial Disclosures (TCFD) and the Greenhouse Gas Protocol (GHG Protocol).

Corporate Governance and Climate-Related Risks

The proposed rules would require companies to disclose how their boards oversee and manage climate-related risks and targets, and to identify any director with expertise in climate-related risks. A company that lacks a director with this expertise would not be able to make such identification and thus may receive pressure from shareholders or otherwise to appoint a climate expert to its board.

Companies would be required to disclose physical and transitional climate-related risks that are reasonably likely to have a material impact on their businesses, results of operations, or financial conditions over the short, medium, and long term. Companies providing such disclosures must include both current and forward-looking statements that facilitate an understanding of whether the implications of the identified climate-related risks have been integrated into the registrant's business model or strategy, including how resources are being used to mitigate climate-related risks. However, the SEC did not define these timeframes, and the proposed rule would leave it up to the registrant to define and disclose its definition of short-, medium-, and long-term time horizons. Additionally, if companies have set climate-related targets or goals, they would be required to disclose the targets and goals, including the baseline year and their progress toward such goals. Companies that have adopted a climate-related transition plan would be required to include a description of how they plan to mitigate any identified climate-related physical or transition risks and provide an annual update describing actions taken in accordance with their transition plan.

Emissions Disclosure

Companies would also be required to disclose their GHG emissions for the fiscal years covered by the financial statements included in the applicable periodic report or registration statement. This disclosure must include contextual information, such as a description of how the metric was derived, a description of significant inputs and assumptions used, and policy decisions made by the registrant to calculate the specified metric. Under the proposed rule, every company would be required to disclose Scope 1 (direct emissions) and Scope 2 (emissions from consumption of purchased energy). Notably, Scope 3 (emissions from supply chain that are out of a company's control) emissions disclosure would only be required if material to a company, or where a company has included Scope 3 emissions as part of a public GHG emissions reduction target or goal, even if immaterial. Scope 3 emissions would be required to be disclosed if there is a substantial likelihood that a reasonable investor would consider Scope 3 emissions important when making an investment or voting decision. Smaller reporting companies would only be required to disclose their Scope 1 and 2 emissions. Under the proposed rule, Scope 1 and Scope 2 emissions must be disclosed on both an aggregated and disaggregated basis to the extent such data is available; however, Scope 3 disclosure can be disclosed as an estimated range so long as companies using a range disclose their reasons for doing so and their underlying assumptions. Additionally, if companies use carbon offsets or renewable energy credits, they would be required to disclose the costs and risks associated with purchasing or selling such offsets and credits.

Attestation Report

Accelerated and large accelerated filers would be required to include an attestation report from an independent attestation service provider for their Scope 1 and Scope 2 emissions beginning in the second year of compliance with the proposed rules. Providers of these attestation reports must be independent from the company and have expertise in GHG emissions, but need not be a registered public accounting firm. The attestation report must provide "limited assurance" (equivalent to the level of assurance provided over a registrant's interim financial statements included in a Form 10-Q) in the second and third fiscal years of compliance with the proposed rules and "reasonable assurance" (equivalent to the level of assurance provided in an audit of a registrant's annual financial statements included in a Form 10-K) from the fourth fiscal year of compliance with the proposed rules and beyond. Because of the nature of Scope 3 emissions, so long as companies have a reasonable basis and the Scope 3 emissions are disclosed in good faith, Scope 3 emissions disclosures will fall under a safe harbor and will not require attestation.

Financial Statement Disclosure Requirements

Companies would also be required to make climate-related disclosures in their notes to financial statements, including disclosure of the financial impact of climate-related events (such as flooding, drought, fires, etc.) and transition activities, including transition risks identified by such companies. Companies would also be required to disclose expenditures for climate-related risk mitigation and to disclose financial estimates and assumptions impacted by such climate-related events and transition activities. The disclosure requirements for financial metrics will be subject to a 1 percent materiality threshold of the related line item. These financial metrics would be subject to audit by a company's independent registered public accounting firm and would fall under a company's internal control over financial reporting.

Compliance Dates by Registrant Type

As proposed, the rule would apply to both domestic and foreign private issuers other than registered investment companies (but including business development companies), asset-backed issuers and MJDS filers. However, the proposed rules include a phase-in period for all companies, with the compliance date dependent upon the registrant's filer status. The table below is an example of the compliance dates for each registrant type if the proposed rules are adopted in 2022:

	Compliance Date	
Registrant Type	**All disclosures except Scope 3**	**Scope 3**
Large accelerated filer	Fiscal year 2023 (filed in 2024)	Fiscal year 2024 (filed in 2025)
Accelerated filer and non-accelerated filer	Fiscal year 2024 (filed in 2025)	Fiscal year 2025 (filed in 2026)
Smaller reporting company	Fiscal year 2025 (filed in 2026)	Exempted

Filer Type	**Scope 1 and 2 GHG Disclosure Compliance Date**	**Limited Assurance**	**Reasonable Assurance**
Large Accelerated Filer	Fiscal year 2023 (filed in 2024)	Fiscal year 2024 (filed in 2025)	Fiscal year 2026 (filed in 2027)
Accelerated Filer	Fiscal year 2024 (filed in 2025)	Fiscal year 2025 (filed in 2026)	Fiscal year 2027 (filed in 2028)

Seven Short-term Action Items

If adopted, the final rules are likely to differ from the proposed rules (and may be challenged in court), but will nonetheless drive stakeholder demands for climate-related disclosures. Accordingly, it would be prudent for companies to start taking certain actions now, including to:

- Familiarize themselves with TCFD and GHG Protocol frameworks.
- Consider changes in corporate charters, policies and internal disclosure controls and procedures around the disclosure of GHG emissions data.
- Prepare for the potential disclosure requirements by gathering climate-related data, informing their boards about the proposed rules and building the climate-related expertise of their senior executives and board members. For more information on preparing for potential disclosure requirements, please watch this webinar on ESG Shareholder Proposals hosted by Farzad Damania and read "ESG Shareholder Proposals: Practical Guidance from Proxy, Legal, IR and Consulting Perspectives" by Farzad Damania and Ryan Lilley.
- Consider the extent to which climate-related disclosures are appropriate under existing requirements. The SEC recently released climate-related comment letters for 25 different companies relating to existing rules. The comment letters provide insight as to existing disclosure requirements and obligations. For more information on existing climate-related disclosure obligations, see "SEC's Climate-Related Comment Letters – Avoiding Potential Pitfalls" by Farzad Damania and Ryan Lilley.
- Take a hard look at compliance costs for climate-related disclosures. If adopted, the proposed rules will likely have a significant impact on compliance costs with the imposition of new disclosure requirements. While 90 percent of S&P 500 companies publish sustainability reports with some of the disclosure that the proposed rules would require, less than 20 percent include any reference to ESG factors in their SEC filings. These proposed disclosure requirements are likely to have a significant impact on smaller companies that are not prepared to make such disclosures, despite being exempted from reporting Scope 3 emissions.
- Consider the impact of announcing climate-related targets and goals, especially with regard to Scope 3 emissions targets.
- Consider commenting on the proposed rule. The comment period will remain open through at least May 20, 2022.

ESG Shareholder Proposals: Practical Guidance from Proxy, Legal, IR and Consulting Perspectives

By Farzad F. Damania, Jennifer L. Howard and Ryan A. Lilley

On January 6, Katten Capital Markets partner Farzad Damania, along with Zally Ahmadi of D.F. King, George Lu of ADEC ESG Solutions and Ari Frankel of Solebury Trout, presented a program sharing their insights into the trends in ESG shareholder proposals and the steps companies should take to meet investor expectations. They noted that shareholder proposals received a record level of support, reaching 36.3 percent across all ESG categories. The panel measured the ESG trends using data for companies within the Russell 3000 Index during the 2021 proxy season. A number of trends and developments in ESG are highlighted below.

Support for Environmental Proposals Booms

There were 105 shareholder proposals on environmental reform in 2021, and nearly half of all environmental proposals that made it to the ballot passed (compared to zero in 2019). The top environmental proposal submitted was a request for climate change reporting, and support increased from 35 percent in 2020 to 52 percent in 2021. Additionally, 80 percent of greenhouse gas (GHG) emissions-related proposals that made it onto ballots received majority support in 2021.

Say on Climate: In 2021, a "say on climate" initiative emerged. Such proposals request an annual advisory vote on a company's climate-related plans. Proponents have indicated that they plan to file several similar proposals for the 2022 proxy season. However, such "say on climate" proposals had significantly less success than other environmental proposals in 2021. Four "say on climate" proposals were voted on but did not pass, with three receiving 30 percent support and one receiving only 7 percent support.

Social Proposals Have Strong Presence in Top 10 ESG Proposals

In 2021, the number of social proposal submissions nearly tripled. Of the 258 that were proposed, 133 made it to the ballot. These social proposals included EEO-1/diversity reporting, board and management diversity proposals, and racial equity proposals. Within these three categories, EEO-1/diversity reporting had the highest number of submissions and received an average level of support of 55.66 percent in 2021. Notably, pension funds and social impact investors, including the NYC Comptroller's Office and Calvert Research, are continuing with their campaigns in 2022, demanding various forms of workforce disclosure, including the publication of EEO-1 reports.

Board and Management Diversity: Board and management diversity proposals received the highest average level of support at 61.98 percent in 2021, compared to just 13.3 percent in 2019. Proxy advisory firms and institutional investors continue to take action and have stated that they expect companies to provide board diversity disclosures. Some institutional investors have gone further and now expect companies to disclose the role diversity plays in their long-term strategy, their diversity goals and progress toward those goals.

Governance Proposals Continue to Have a Strong Presence

Nearly 80 percent of governance proposals went to a vote in the 2021 proxy season. The most common governance proposal continues to be the written consent proposal, and support for such proposals increased from 35 percent in 2020 to 41 percent in 2021. Eight written consent proposals passed in 2021 compared to just two in each of 2020 and 2019. Average support for proposals requesting the elimination of supermajority provisions also increased to almost 90 percent. During the 2021 proxy season, 18 proposals to eliminate the supermajority voting provision made it onto ballots and ultimately received over a majority of shareholder support. Notably, in 2021, there was a decrease in the number of proposals to lower the ownership threshold to call a special meeting but an increase in the number of proposals to require a majority vote for the election of directors. The average support for these proposals was 35.05 percent and 51.63 percent, respectively.

SEC Developments on Shareholder Proposals

Background: Rule 14a-8 of the Securities Exchange Act provides the procedure whereby a shareholder can propose a matter to be voted on at a company's shareholder meeting. Under Rule 14a-8, a public company must include a shareholder's proposal in its proxy statement if the shareholder proposed the matter using proper procedure and the company lacks a substantive basis to exclude such proposal.

SLB 14L: On November 3, 2021, the staff of the Division of Corporation Finance of the SEC (Staff) published Staff Legal Bulletin No. 14L (SLB 14L), which limits the ability of public companies to exclude shareholder proposals relating to social issues from proxy statements and provides clarification regarding the procedural requirements applicable to shareholder proposals. SLB 14L rescinds the interpretive positions taken in Staff Legal Bulletin Nos.14I (2017), 14J (2018) and 14K (2019). By rescinding the SEC's prior positions, SLB 14L creates a tougher threshold for no-action relief, and will likely result in more E&S styled shareholder proposals. The Staff stated in SLB 14L that it will decide whether to allow a proposal based on the social policy significance of the issue in the shareholder proposal, rather than the significance of the policy issue to the subject company. Accordingly, companies no longer need to include a board analysis under the economic relevance or ordinary business exclusions.

Human Capital Management: SLB 14L provides new guidance stating that proposals raising human capital management issues with a broad societal impact, such as employment discrimination, may no longer be excludable on economic relevance and ordinary business grounds. With the Staff reducing avenues to exclude shareholder proposals, more companies are likely to consider other grounds for excluding shareholder proposals, including substantial implementation and negotiation with shareholder proponents in their efforts to convince the proponents to withdraw their proposals.

Climate Change Initiatives: SLB 14L also specifically provides that when a shareholder proposal requests that a company adopt targets or timelines for climate change initiatives, the Staff may not grant no-action relief on the basis of ordinary business, so long as the proposals afford discretion to management as to how to achieve such goals. As SLB 14L clearly states the Staff's position on climate-related proposals, it is expected to result in more proposals, including, for example, adoption of science-based targets and net zero commitments.

Mechanics of Climate Proposals

Task Force on Climate-Related Financial Disclosures (TCFD) and Risk Assessment: The TCFD was created in 2015 by the Financial Stability Board to develop consistent climate-related financial risk disclosures. The number of companies that support TCFD has rapidly increased since 2017. In 2017, fewer than 500 companies supported TCFD but that number has nearly doubled each year since. As of April 27, there are 3,300 companies supporting TCFD in 93 jurisdictions. The TCFD provides recommendations for companies aiming to improve their climate-related financial risk disclosures. First, the TCFD recommends that a company establish board oversight and management of climate-related risks such as physical and transitional risks. Physical risks arise from exposure of company-owned facilities, supply chains and capital assets to sea-level rise, flooding, heat wave, and the like. Transitional risks, on the other hand, are the risks inherent in changing strategies and policies in an effort to reduce reliance on carbon. Second, a company should identify climate-related risks and opportunities by conducting scenario analyses to evaluate mechanisms available to address climate-related risks and opportunities, the magnitude and likelihood of climate-related risks impacting the company, and the resilience of the company against climate-related risks. Third, a company should manage climate-related risk by establishing an enterprise risk management program. A company should use metrics to assess climate-related risks and opportunities and demonstrate performance with an emphasis on GHG data management. A company should integrate such metrics into the company's enterprise risk management program. Finally, a company should establish internal education and engagement related to climate change and ESG initiatives.

Science Based Targets (SBT): When establishing a low-carbon transition plan, companies should consider guidance and frameworks from the Science-Based Targets initiative (SBTi) and from GHG Protocol. SBTi is an organization committed to reducing emissions and offers resources and guidance for companies establishing a science-based low-carbon transition plan. GHG Protocol partners with the World Resources Institute and the World Business Council for Sustainable Development to establish global standardized frameworks to measure and manage greenhouse gas. One consideration for companies establishing a low-carbon transition plan is the plan's boundary, under which targets must cover company-wide Scope 1 and Scope 2 emissions and all relevant GHGs as required in GHG Protocol's international standards. Companies also must consider the timeframe, which must cover a minimum of five years and a maximum of 15 years from the date of announcement of the target. Moving too far beyond 15 years can make planning for future events impractical. For many companies, the minimum target will be consistent with the level of decarbonization required to keep global temperature increase to 1.5°C compared to pre-industrial temperatures. Companies should set ambitious Scope 3 targets, which is required by SBTi when Scope 3 emissions constitute over 40

percent of a given company's overall emissions. Scope 3 emissions fall into 15 distinct categories, but not all of these categories are inherently relevant to any one company. Therefore, companies should screen Scope 3 categories for relevancy. Once companies target the most relevant Scope 3 emissions, companies should inform their investors on how they will act to reduce Scope 3 emissions. Companies should make mitigation and reducing Scope 3 emissions, a priority, but Scope 3 emissions are not in a company's direct control, so setting appropriate investor expectations is important. Finally, companies should disclose company-wide GHG emissions inventory on an annual basis as part of the plan.

Combination of TCFD and Science-Based Targets: Companies should consider risk and opportunities throughout operations (GHG inventory, TCFD/ERM analysis). Prioritization of projects and capital investments (technologies, energy efficiency, and renewables) is vital for reducing emissions and meeting targets. Companies should combine TCFD and SBT results to identify key risk and opportunity areas. Additionally, companies should convene or create an ESG steering committee for a multidisciplinary approach and develop an internal understanding and public-facing narrative of the business case for a low-carbon transition plan. The effect of combining TCFD and SBT results is complementary, as companies that follow TCFD procedures will be in a better position to meet their SBTs. Conversely, companies that set SBTs in compliance with SBTi and GHG Protocol standards will be in a strong position to disclose the information required by the TCFD.

Proactive Engagement of Shareholders

Create a Narrative: There is an opportunity to create comradery within an ESG-focused company, including with employees and suppliers, and to satisfy investor expectations. Part of creating a narrative is determining what is important to a company and creating internal engagement to bring a company together around that focus point. Once a company determines what is material to its ESG plan, it should establish a narrative and communicate that narrative to shareholders. Generally, if a shareholder proposes an ESG initiative focusing on a particular issue, that issue is probably material to the company.

Be Proactive: Many shareholders are willing to side with companies once they see those companies making genuine efforts to address their concerns. Shareholders are more sophisticated than ever before and are aware of the various nuances for proposals and for meeting goals. While there is an uptick in environmental proposals right now, shareholders are not currently expecting full programs to be in place. If a shareholder proposal is submitted before a company has an ESG program in place, the company should focus on communicating its sustainability journey, which typically includes several steps: collecting data, analyzing the data, creating a plan, implementing the plan, tracking and automating the company's progress and reporting back to shareholders. A company should consider the steps it wants to take and when, but it should try not to overcommit. Companies that have engaged with shareholders and clearly communicated their plans have had some success in convincing proponents to withdraw their proposals. However, even companies with strong ESG programs can encounter unexpected shareholder proposals. These situations usually arise when there is not enough proactive engagement with the shareholder base. Some companies have been successful in getting these proposals withdrawn by providing key information to the proponent. Companies that have proactively engaged with shareholders have had more success in avoiding proposals, having proposals withdrawn and defeating proposals that have gone to a vote.

Sweeping SEC Proposals Raise Significant Concerns for SPAC Market

On March 30, the SEC released comprehensive proposals for rule changes that would materially expand the liability regime for SPAC transactions, including by limiting the availability of a commonly used safe harbor for forward-looking statements and broadening the scope of who may be deemed a statutory underwriter in connection with a de-SPAC transaction, which, alongside many of the other notable changes being proposed by the SEC, may have significant chilling effects on the SPAC market. If adopted, the proposals would represent the most expansive increase in the regulation of SPACs since the investment vehicles emerged in the early 1990s.

By Timothy J. Kirby, Mark D. Wood and Richard D. Marshall

With special purpose acquisition companies (SPACs) continuing to take the US equity markets by storm,[i] the Securities and Exchange Commission (SEC, Commission or Staff) has released long-telegraphed proposals for sweeping new regulations governing SPACs and their related business combinations (de-

SPACs), whose broad scope, new disclosure requirements and material liability implications for a wide array of SPAC market participants have, if adopted, the potential to fundamentally alter the regulatory landscape for SPAC and de-SPAC transactions going forward. The summary fact sheet and full proposing release (Proposing Release), which was issued by the SEC on March 30 and supported by a 3-1 margin of the SEC's Commissioners, cites "greater transparency and more robust investor protections … [which] could assist investors in evaluating and making investment, voting, and redemption decisions with respect to [SPAC transactions]" as the (purported) rationale for the comprehensive wave of amendments (Proposed Rules).

The Proposed Rules touch on virtually all aspects of the SPAC process and raise concerns for all SPAC market participants, from sponsors, management teams and private company acquisition targets, to underwriting banks, supplementary capital providers such as PIPE investors, and even financial advisory firms that are not providing any direct financial support for a transaction. As discussed in past editions of the SPAC Report, Chairman Gensler has long advocated the view that de-SPAC transactions are functionally equivalent to a traditional initial public offering (IPO) by that private operating company, and should be regulated as such. The Proposed Rules follow the contours of the Chairman's prior statements and, if adopted, would result in a greatly expanded liability profile for de-SPAC transactions, one more akin to a traditional IPO, including such novel expansions as deeming underwriters in SPAC IPOs to be underwriters in the subsequent de-SPAC transaction if they take any steps to facilitate the de-SPAC transaction. Commissioner Hester M. Peirce cited this expansive approach to SPAC transactional liability in particular in her blistering dissent, and found that the sum of the elements of the Proposed Rules, "rather than simply mandating sensible disclosures around SPACs and de-SPACs, something I would have supported — seem [instead to be] designed to stop SPACs in their tracks."

The SEC is seeking public comments on the Proposed Rules through May 31, 2022, or 30 days after publication in the Federal Register, and given the volume and dynamic nature of the proposals, a vigorous and active comment period is expected. Key highlights of the Proposed Rules include:

- Amending the definition of "blank check company" such that the liability safe harbor provided by the Private Securities Litigation Reform Act of 1995 (PSLRA) for forward-looking statements, such as financial projections, would be unavailable for de-SPAC registration statements;
- A new rule that deems underwriters in SPAC IPOs to be underwriters in subsequent de-SPAC transactions if they take steps to facilitate the de-SPAC transaction or any related financing transaction, or otherwise participate in the de-SPAC transaction, and potentially deeming other de-SPAC participants as statutory underwriters as well, including financial advisors and PIPE investors, such that the range of actors facing potential liability exposure in connection with participation in a SPAC or de-SPAC transaction would be greatly expanded; and

- Requiring additional disclosures in SPAC and de-SPAC registration statements, including with respect to conflicts of interest, dilution and the "fairness" of de-SPAC transactions from the perspective of retail holders (which, if adopted, may result in a fairness opinion becoming a de facto requirement for consummating a de-SPAC transaction).

Below we detail some of the main elements of the Proposed Rules, with analysis and brief discussion of the potential implications for the SPAC market if the Proposed Rules are adopted.

Projections, Guidance and PSLRA Safe Harbor

PSLRA Safe Harbor. The PSLRA provides a safe harbor for forward-looking statements under federal securities laws, pursuant to which a company is protected from liability in any private right of action for forward-looking statements included in disclosure documents filed with the Commission when the forward-looking statements are identified as such and are accompanied by meaningful cautionary statements.[ii] The PSLRA is not available in traditional IPOs or offerings involving "blank check companies." Most SPAC and de-SPAC transactions however, are specifically structured such that the SPAC would not be considered a "blank check company,"[iii] suggesting the PSLRA safe harbor should be available to them. Market commentators have cited the availability of the PSLRA safe harbor as granting a "perceived freedom to use projections in connection with de-SPAC transactions, [as a result of the perception of]… reduced liability exposure." Certain critics have even gone so far as to claim that the availability of the PSLRA safe harbor has been critical to the recent SPAC boom, creating a "regulatory arbitrage" whereby sponsor teams capitalized on a loophole in the regulatory system that would have otherwise prevented many SPAC targets from reaching the public markets,[iv] particularly given many of the acquisition targets brought public over the last two years via de-SPAC have been pre-revenue, and therefore relied primarily on forward guidance and projections of future financial results to solicit investor interest, which would likely have been considered off-limits in a traditional IPO. The Proposed Rules amend the definition of "blank check company" (for purposes of the PSLRA) to explicitly exclude SPACs from the safe harbor.

Even if SPACs are formally excluded from use of the safe harbor, note that in certain instances, a SPAC or target company may feel compelled to disclose projections in disclosure documents, despite the increased liability risk, for example: (i) in order to comply with state law requirements regarding disclosure of all information reviewed by a board of directors when considering an acquisition; (ii) to avoid claims that not disclosing such information was a material omission under federal securities law anti-fraud provisions; or (iii) if the projections were otherwise required to be disclosed pursuant to Regulation M-A. When combined with the proposed expansion of underwriting liability for SPAC IPO underwriters in connection with subsequent de-SPACs (as further discussed below), the unavailability of the safe harbor may lead underwriters to demand structural and/or compensation changes in order to limit (or be compensated for) the increased liability profile.

Increased Disclosures of Factors Underlying Projections. If projections or guidance are included in a de-SPAC registration statement, the Proposed Rules would require disclosure regarding: (i) the purpose for which the projections were prepared and the party that prepared them, (ii) the basis and all material assumptions underlying the projections, and any factors that may materially impact such assumptions (for example clearly

outlining material growth rates or discount multiples used in preparing projections, and the reasons for selecting such growth rates or discount multiples), and a discussion of any factors that may cause such assumptions to no longer be reasonable and (iii) whether the disclosed projections remain accurate from the perspective of the board or management of the SPAC or target company, as applicable, as of the date of the relevant filing with the Commission (Proposed Item 1609). As most de-SPAC transactions already include fulsome disclosure regarding the assumptions underlying projections, we would not expect such increased disclosure requirements to be overly troubling to the SPAC market.

Underwriter Status and Liability in a de-SPAC Transaction

SPAC IPO Underwriters and Other de-SPAC Participants. Proposed Rule 140a would deem SPAC IPO underwriters who take any steps to facilitate a de-SPAC transaction (or any related financing transaction in the context of such de-SPAC, such as a concurrent

PIPE financing, or who otherwise directly or indirectly participates in such de-SPAC transaction), a statutory underwriter with respect to such de-SPAC transaction, conferring previously unforeseen underwriter liability risk.

- Proposed Rule 140a appears to be the SEC's attempt to impose a "gatekeeper liability" regime on the SPAC market, an approach long-supported by Chairman Gensler, which would subject market participants that the SEC has deemed to be the SPAC market's "gatekeepers" — including notably the investment banks involved in the de-SPAC process — to underwriter liability risk, the theory being that the approach encourages such "gatekeepers" to increase their own scrutiny of SPAC disclosure documentation, and otherwise conduct a more extensive due diligence exercise, in an effort to mitigate their own expanded risk profile.
- Note the Proposing Release makes clear proposed Rule 140a is not intended to limit or be an exhaustive assessment of what constitutes an "underwriter" for purposes of Section 2(a)(11) of the Securities Act, with the SEC noting that "financial advisors, PIPE investors, or other advisors, depending on the circumstances, may be deemed statutory underwriters in connection with a de-SPAC transaction if they are purchasing from an issuer "with a view to" distribution, are selling "for an issuer," and/or are "participating" in a distribution." Further note that affirming statements released by Commissioners Crenshaw and Lee both cite deferred underwriting compensation payable to SPAC IPO underwriters upon the consummation of a de-SPAC as problematic, raising concerns that the SEC would view merely the receipt of a deferred underwriting fee as leading to exposure for SPAC IPO underwriters to liability in connection with a de-SPAC, even if they are not actively participating in such de-SPAC transaction, for example by assisting with arranging a related PIPE financing. Deferred underwriting compensation is a standard feature of virtually all SPAC IPOs, allowing SPAC teams to reach the public markets without excessive up-front expense, while incentivizing underwriting banks to only work with and market SPACs with skilled management teams who are likely to get a deal done. If adopted, Proposed Rule 140a may result in IPO underwriters demanding full compensation up-front (i.e., at the time of the initial SPAC IPO) in order to reduce such liability risk, which may be a prohibitive cost for many SPAC sponsor teams.
- Significantly, note that Proposed Rule 140a is characterized by the SEC as a "clarification" rather than a rule change — suggesting that banks may already be subject to underwriter liability for past de-SPAC transactions, and keeping the door open to retroactive claims. It is notable that in response to the Proposed Rules, numerous underwriters have temporarily paused work on new SPAC IPOs, and certain larger financial institutions may have permanently left the space.

Co-Registration by Target. The Proposed Rules would amend Form S-4 and Form F-4, such that acquisition targets would be required to be listed as co-registrants in the registration statement filed in connection with a de-SPAC transaction, therefore subjecting the acquisition target, as well as its officers and directors, to potential liability under Section 11 and Section 12 of the Securities Act for material misstatements or omissions in the registration statement disclosure. Note that many de-SPAC transactions are already structured such that the target company is the registrant, with the target's board and management signing the registration statement.

De-SPAC Transactions are Also an Offer of Securities to Existing SPAC Investors. Proposed Rule 145a would deem any business combination involving (x) a reporting shell company (i.e., a SPAC) and (y) an operating company as involving a sale of securities to such reporting shell company's shareholders (in addition to the target company's shareholders), requiring that the registration statement filed in connection with the de-SPAC transaction register not just the offering of shares to the target company's shareholders, but also an offering to the existing shareholders of the SPAC, who would be deemed to be electing to receive new shares of the combined entity (if they do not avail themselves of their redemption right). Proposed Rule 145a reflects the SEC's view that the de-SPAC transaction is the "SPAC target IPO" and, although the SPAC's existing shareholders may not be receiving new shares at the time of the de-SPAC (as the target company merges into the SPAC shell vehicle and the existing SPAC shareholders typically, if they do not redeem, simply hold on to their pre-de-SPAC equity), that they should be treated as being distributed new securities at the time of the de-SPAC so that they would be afforded the same disclosure and liability protections with respect to material misstatements or omissions in de-SPAC disclosure documents as traditional IPO investors.

Dilution Disclosure

Increased Disclosure Regarding Dilution Events. The Proposed Rules include additional and more explicit disclosure requirements regarding dilutive events that will or may occur in the future in connection with both the SPAC IPO and de-SPAC transaction, including requiring: (i) for SPAC IPOs, simplified tabular dilution disclosure on the prospectus cover page (Proposed Item 1602(a)(4)) and a further description of material potential sources of dilution following the IPO, including tabular disclosure of the amount of potential future dilution from the public offering price that will be absorbed by non-redeeming SPAC shareholders upon consummation of the de-SPAC, to the extent quantifiable (in addition to the disclosure already required under Item 506 of Regulation S-K) (Proposed Item 1602(c)); (ii) in connection with a de-SPAC, requiring disclosure of each material potential source of additional dilution that non-redeeming shareholders may experience by electing not to redeem their shares, for example from sponsor compensation, underwriting fees, outstanding warrants and convertible securities, and any additional financing such as related PIPE financings (Proposed Item 1604(c)); and (iii) in connection with a de-SPAC, requiring a sensitivity analysis be presented in tabular format that shows the amount of potential dilution under a range of reasonably likely redemption levels, and quantifies the increasing impact of dilution on non-redeeming shareholders, as redemptions increase (Proposed Item 1604(c)(1)).

Other Enhanced Disclosure Requirements, 'Fairness' Opinions, Conflicts of Interest, Director Independence

"Fairness" Representations and (Potentially) Opinions. The Proposed Rules would require (i) a statement from the SPAC as to whether it reasonably[v] believes that the de-SPAC transaction and any related financing transactions are "fair" to retail holders of the SPAC (Proposed Item 1606(a)), and (ii) identification of material factors upon which such reasonable belief is based and, to the extent practicable, the weight assigned to each factor, with factors potentially including (x) the valuation of the private operating company, (y) the consideration of any financial projections and (z) any report, opinion or appraisal obtained from a third party (Proposed Item 1606(b)).

Note that the proposed disclosure requirements with respect to the fairness of the transaction, while not specifically requiring a fairness opinion, may, if adopted, result in a fairness opinion becoming a condition to consummating a de-SPAC transaction.

Director Independence and Disinterested Shareholder Approval Disclosure. The Proposed Rules would: (i) require disclosure regarding whether any director voted against, or abstained from voting on, approval of the de-SPAC transaction or any related financing transaction, and if so, identification of the director and, if known after making a reasonable inquiry, the reasons for the vote against the transaction or abstention (Proposed Item 1606(a)); (ii) require disclosure regarding whether the de-SPAC transaction or any related financing transaction is structured so that approval of at least a majority of unaffiliated security holders is required (Proposed Item 1606(c)); (iii) require disclosure regarding whether the SPAC's independent directors have retained an unaffiliated representative to act solely on their behalf for purposes of negotiating the terms of the de-SPAC transaction or any related financing transaction and/or evaluating the fairness of the de-SPAC transaction or any related financing transaction (Proposed Item 1606(d)); and (iv) require disclosure regarding whether the de-SPAC transaction or any related financing transaction was approved by a majority of the SPAC's independent directors (Proposed Item 1606(e)). The Proposing Release notes these additional disclosures are intended to allow investors to better evaluate potential conflicts of interest and misaligned incentives in connection with the decision to proceed with a de-SPAC transaction.

Compensation Arrangements and Conflicts of Interest. Proposed Item 1603(b) would require disclosure regarding: (i) any conflicts of interest with respect to determining whether to proceed with a de-SPAC transaction with a specific proposed target and (ii) the compensation arrangements among the SPAC, the sponsor, and their executive officers and directors. Although most SPACs already provide fulsome disclosure regarding the presence of actual or potential conflicts of interest as material risk factors, their inclusion in the Proposed Rules indicate SPAC market participants may wish to renew scrutiny of such conflicts and related disclosure.

Background of the Management Team and Affiliate and Related Party Transactions. Proposed Item 1603(a) would require additional disclosure about the sponsor, its affiliates and any promoters of the SPAC in registration statements and schedules filed in connection with SPAC IPOs and de-SPAC transactions, including disclosure regarding: (i) the experience, material roles, and responsibilities of such parties, as well as any agreement, arrangement or understanding (x) between the sponsor and the SPAC, its executive officers, directors or affiliates, in determining whether to proceed with a de-SPAC transaction and (y) regarding the redemption of outstanding securities; (ii) the controlling persons of the sponsor and any persons who have direct and indirect material interests in the sponsor, as well as an organizational chart that shows the relationship between the SPAC, the sponsor and the sponsor's affiliates; (iii) in tabular form, the material terms of any lock-up agreements with the sponsor and its affiliates; and (iv) the nature and amounts of all compensation that has or will be awarded to, earned by, or paid to the sponsor, its affiliates and any promoters for all services rendered in all capacities to the SPAC and its affiliates, as well as the nature and amounts of any reimbursements to be paid to the sponsor, its affiliates and any promoters upon the completion of a de-SPAC transaction.

Fiduciary Duties. Proposed Item 1603(c) would require disclosure regarding: (i) the fiduciary duties each officer and director of a SPAC may owe to other companies, including whether and to what extent the SPAC's officers or directors may have to navigate conflicts of interest and their obligations under the laws of the jurisdiction of incorporation or organization of the SPAC and a target company; (ii) that SPAC directors and officers may be compelled to act in the interest of another company or companies that compete with the SPAC for business combination opportunities; and (iii) that SPAC directors and officers may have their attention divided such that it may affect their decision-making with respect to the SPAC. Similar to Proposed Item 1603(a), the Proposing Release notes that it does not expect any incremental disclosures required by Proposed Item 1603(c) to be overly burdensome as, given the significance of such fiduciary relationships, it is unlikely that a director or officer — and by extension, the SPAC — would not already know what relationships would require disclosure.

Investment Company Act

Investment Compact Act Safe Harbor. The Proposed Rules include a safe harbor for SPACs that would deem a SPAC to not be an investment company[vi] under the so-called "subjective" test[vii] for status under the Investment Company Act of 1940 (1940 Act), if certain conditions are met, including that: (i) the SPAC's assets consist solely of government securities, government money market funds and cash; (ii) the SPAC's activities are limited to seeking to complete a single de-SPAC transaction (which may involve the combination of multiple targets) as a result of which the surviving public entity will be primarily engaged in the business of the target company or companies[viii] and will have a class of securities registered on a national securities exchange; (iii) the activities of a SPAC's officers, directors and employees are primarily focused on activities related to seeking a target company, and the board of directors of the SPAC adopts an appropriate resolution regarding this business purpose; and (iv) the SPAC announces a business combination within 18 months of its IPO, and completes a business combination within 24 months of its IPO.

Going Forward

After peaking in the mid-1990s, the number of public company listings in the United States has declined by more than [25 percent over the last 20 years](). Today, roughly [70 percent of capital]() is raised in private markets, cutting off many retail investors from the opportunity to invest in early-stage companies. Promoting access to the public markets for smaller investors remains an elusive but constant mantra of the SEC, agnostic to changing political tides. The resurgence of SPACs over the last several years represents a promising opportunity that even Commissioners who voted in support of the Proposed Rules [have cited]() as having the potential to help address certain of the challenges private operating companies have noted as behind their hesitation to entering the public markets. Unfortunately, it is likely the Proposed Rules, at least in their current form, and in particular the proposed expansion of the liability regime that limits the availability of the forward-looking statements safe harbor and broadens the scope of who may be deemed a statutory underwriter in connection with a de-SPAC transaction, will be subject to legitimate and substantial criticism from market participants, both as overly harsh and burdensome, and as likely to induce significant chilling effects on SPAC market activity generally.

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[i] 2020 *had* been dubbed the "Year of the SPAC" — as a result of the record number of SPAC issuances and cash raised by sponsor teams — that is until 2021 again shattered the record books, with 613 SPACs debuting on the public markets and over $162B in aggregate proceeds raised during the course of the year. In 2021, SPACs comprised over 63 percent of all IPOs, and represented nearly half of all proceeds raised. Although the number of SPAC issuances slowed somewhat during Q1 2022, after nearly doubling year over year from 2020 to 2021, the market remains robust, with 59 IPOs in 2022 as of the date of this publication. Source: Spacanalytics.com and Spacinsider.com.

[ii] See Section 27A of the Securities Act of 1933, as amended (Securities Act) and Section 21E of the Securities Exchange Act of 1934. Note that the PSLRA does not impact the Commission's ability to bring enforcement actions relating to forward-looking statements.

[iii] To take advantage of the PSLRA safe harbor, SPACs rely on the fact that under Rule 419 of the Securities Act, if they raise more than $5 million in a firm commitment underwritten initial public offering listed on a national securities exchange, they are excluded from the definition of "blank check company" because they are not selling "penny stock," and would therefore be eligible for the safe harbor. See CFR § 230.419 and CFR § 240.3a51-1.

[iv] Amanda M. Rose, "[SPAC Mergers, IPOs, and the PSLRA's Safe Harbor: Unpacking Claims of Regulatory Arbitrage]()."

[v] The Proposing Release does not defined what constitutes a "reasonable" belief, but instead notes merely that as a result of this standard: "SPACs may incur additional costs associated with proposed Item 1606(a) to the extent that, in response to this proposed item, SPACs newly seek to obtain fairness opinions."

[vi] In September 2021, Katten joined more than 60 law firms in a joint statement (available [here]()) responding to private litigation that asserted that SPACs are unregistered investment companies as without factual or legal basis.

[vii] The Proposing Release notes: "The safe harbor we are proposing only addresses investment company status under Section 3(a)(1)(A) of the Investment Company Act, commonly known as the "subjective test." Section 3(a)(1)(C) of the Investment Company Act provides an alternate "objective test" that defines an "investment company" as any issuer that is engaged or proposes to engage in the business of investing, reinvesting, owning, holding, or trading in securities, and that owns or proposes to acquire investment securities, having a value exceeding 40 percent of the value of the company's total assets (exclusive of Government securities and cash items) on an unconsolidated basis. If a SPAC owns or proposes to acquire 40 percent or more of investment securities, it would likely need to register and be regulated as an investment company under the Investment Company Act."

[viii] Note this requirement is intended to prevent transactions typical of private equity funds, where a company is purchased for the purpose of disposition within a few years: "Thus, to rely on the rule, the SPAC must have a business purpose aimed at providing its shareholders with the opportunity to own interests in a public entity that, in contrast to an investment company, will either be an operating company, or will, through a primarily controlled company, operate such operating company."

SEC Rolls Out Modernized Filing Fee Payment and Exhibit Rules

By Daniel O. Imahiyerobo

The Securities and Exchange Commission (SEC) has adopted rules modernizing filing fee disclosures and payment methods. The changes are aimed at reducing reliance on a dated an onerous process for filers and Commission staff.

On January 31, the SEC's new rules concerning registration fee disclosure became effective. The new rules also update the payment methods for registration fees, which rules will become effective on May 31. Filers may voluntarily comply with the new rules before the applicable compliance date once the EDGAR system has been modified for compatibility with the new rules.

Filing Fee Disclosure

Among other things, the amendments require filers to provide all required information for filing fee calculations in a structured exhibit, replacing the filing fee table on the cover page of most fee-bearing filings. The new exhibit requirement and the related instructions are set forth in Item 601(b)(107) of Regulation S-K and the relevant SEC forms and schedules. The tables required for each form vary slightly, and each form has also been amended accordingly. This new fee table exhibit is required as of January 31.

The amendments will also require the filing fee exhibit to be tagged with XBRL. The XBRL tagging requirement has a phased-in compliance date — July 31, 2024 for large accelerated filers and July 31, 2025 for all other filers.

The amendments will affect most fee-bearing forms, schedules and statements filed under either the Securities Act of 1933, as amended (including Forms S-1, S-3, S-4, S-8, S-11, F-1, F-3 and F-10), the Securities Exchange Act of 1934, as amended (including Schedules 13E-3, 13E-4F, 14A, 14C, TO and 14D1-F), and the Investment Company Act of 1940, as amended (including Forms N-2, N-5 and N-14).

'Pay-As-You-Go' Filers

Under the new rules, all Rule 424 final prospectus filings for shelf takedowns from a Form S-3 or a Form F-3, as applicable, will require a separate filing fee exhibit, regardless of whether fees were prepaid by the issuer. For a well-known seasoned issuer relying on Rule 456(b) to "pay as you go" when it does a takedown from an effective shelf registration statement on Form S-3 or Form F-3, as applicable, under newly-amended Rule 424(g)(1), the issuer's registration fee exhibit is required to comply with a specific table format shown in Form S-3 or Form F-3, respectively. For all other Rule 424 filings by issuers that are not using "pay as you go," a table is not required. However, the maximum aggregate amount or maximum offering price of the securities to which the

prospectus relates, along with a statement identifying the filing as a final prospectus for the offering, must be included within the final prospectus itself.

Filing Fee Payment Methods

In another step toward modernization, the amendments eliminate the option to pay filing fees via paper check and money orders. The SEC will continue to accept filing fee payments via wire transfer. The amendments also add the option to pay filing fees by ACH transfer and by debit or credit cards issued by US banks (subject to a daily and per filing fee limit of $25,000). In the adopting release for the amendments, the SEC advised issuers to consider settlement timing for ACH transfers and debit or credit card payments and to time required payments accordingly. The amended fee payment rules will become effective on May 31.

Filing Fee Offsets

The amendments modify fee offset rules and require issuers to provide additional information about fee offset sources. Rule 457(a) of the Securities Act currently requires a company registering securities to pay an additional fee in connection with any pre-effective amendment to a registration statement in which it seeks to increase the amount of securities registered or to register a new class of securities, even if the company is concurrently decreasing the amount of securities of another class it is registering (i.e., the SEC prohibits filing fee refunds). Form instructions will be amended to clarify that an issuer that previously paid a filing fee for a registration statement can rely on Rule 457(b) to use such fee to offset any new fees resulting from an increase in the amount of one or more classes of securities or the addition of one or more classes concurrently with a decrease of one or more classes of securities in the same registration statement. The amendments are limited to issuers that have not previously used Rule 457(o), which allows for the filing fee to be calculated based on a maximum aggregate offering price instead of a number of securities and is most often used in connection with shelf registration statements, to calculate their filing fee.

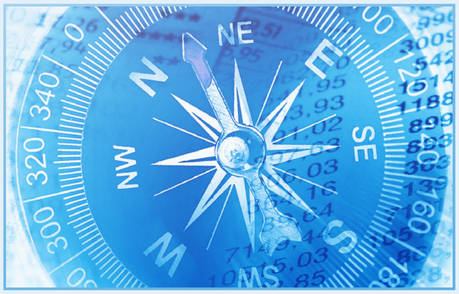
Next Steps

While the changes may require a learning curve, the new rules are being made with the intention of improving the preparation process for SEC filings and payment processing of filing fees, in order to improve efficiency and lower costs. The filing fee exhibit is required for any future filings on the forms that the amendments impacted. The SEC recommends that issuers tag their filing fee exhibits with XBRL prior to the applicable compliance date in order to resolve any problems with their filing vendors in advance and also to ensure that their corporate policies contemplate the new payment methods and to coordinate with their bank accordingly.

Other Recent Developments

By Jennifer L. Howard and Alexa K. Rollins

- On April 8, the SEC announced that, beginning on May 14, the fee rates applicable to most securities transactions will be set at \$22.90 per \$1 million (a substantial increase from the fee rate of \$5.10 per \$1 million for fiscal year 2021). The current fee rate represents a return to levels similar to those prior to 2021 (i.e., \$22.10 in 2020 and \$20.70 in 2019). The fiscal year 2021 fee rate was lower than usual because of unprecedented covered sales volumes during the COVID-19 pandemic.
- On March 22, the SEC issued new compliance and disclosure interpretations (CD&Is) on the topic of mergers and acquisitions. Among other items, the CD&Is encourage companies to file business combination agreements as exhibits to an Item 1.01 Form 8-K announcing a merger, and identify the following non-exclusive list of material terms that should be disclosed in an Item 1.01 Form 8-K announcing a merger: the amount and nature of merger consideration, committed financing arrangements, material terms regarding the securities ownership or management structure of the combined or surviving company, material closing conditions, and anticipated timeframes for SEC filings and closing.



- On March 9, the SEC proposed rules that would enhance and standardize disclosures regarding cybersecurity risk management, strategy, governance and incident reporting by public companies, including business development companies. The proposed amendments would require, among other things, current and periodic disclosure of: material cybersecurity incidents, policies and procedures to identify and manage cybersecurity risks, a company's board of directors' oversight of cybersecurity risk, and a company's management's role and expertise in assessing and managing cybersecurity risk and implementing cybersecurity policies and procedures. The proposed rules would also require annual disclosure of a board of directors' cybersecurity expertise, if any. The comment period for the proposed rules closes on May 9.
- The Division of Corporation Finance and the Division of Investment Management have asked that issuers stop sending paper "courtesy copies" of materials that are filed or submitted via EDGAR, email, online form, or other electronic method of communication unless requested to do so by SEC staff.
- Early in 2022, the staff of the Division of Corporation Finance and the Division of Investment Management of the SEC extended its guidance concerning shareholder meetings in the time of COVID-19. In particular, the SEC encourages issuers to continue to allow shareholder proponents or their representatives to present their shareholder proposals via alternative means, such as by phone, and considers shareholders' inability to attend issuers' annual meetings due to hardships related to COVID-19 to be "good cause" to not attend a meeting in person pursuant to Rule 14a-8(h) under the Securities Exchange Act of the 1934, as amended.
- The Delaware General Assembly is currently considering significant changes to the Delaware General Corporation Law. The proposed amendments, among other things, would permit exculpation for corporate officers, broaden a board's authority to delegate the issuance of stock and options, and expand appraisal rights. If adopted, the proposed amendments would go into effect on August 1.

Save the Date

Society for Corporate Governance 2022 National Conference

June 21-24

Partner **Lawrence D. Levin**, co-head of Katten's National Capital Markets practice, is a featured speaker on Thursday June 23 during a program covering Rule 10b5-1 trading plans. The program is part of the 2022 Society for Corporate Governance National Conference being held June 21-24 at the Hilton Chicago.

Learn mnore about the Society for Corporate Governance.

In Case You Missed It

SEC's Proposals on Private Funds — What to Worry About

Katten presented the "SEC's Proposals on Private Funds — What to Worry About" webinar on March 10. A panel of the firm's most seasoned legal advisors, including Investment Management and Funds co-chairs **Wendy Cohen** and **Allison Yacker**; and Financial Markets and Funds partners **Henry Bregstein**, **Christian Hennion** and **Richard Marshall**, and counsel **Mark Goldstein**, discussed significant items that both registered and exempt investment advisers should be mindful of that are included in the SEC's proposed private funds rule.

Read key takeaways and watch the recorded webinar.

Katten's Annual Financial Markets Regulation Crystal Ball — A Look Back at 2021 and a Look Forward to 2022 Presented by Katten

Katten presented its annual program, "Financial Markets Regulation Crystal Ball — A Look Back at 2021 and a Look Forward to 2022," on Tuesday, March 8. Several members of the firm's Financial Markets and Funds group discussed US financial regulatory and enforcement developments from 2021 and a forecast for 2022. Partner **Carl Kennedy** moderated the panel, which included Financial Markets and Regulation special counsel and chair **Gary DeWaal**; partners **Dan Davis**, **Kevin Foley**, **Sue Light** and **Richard Marshall**; and counsel **James Brady**.

Watch the recorded webinar.

ESG Shareholder Proposals – Practical Guidance from Proxy, Legal, IR and Consulting Perspectives

Capital Markets partner **Farzad Damania** discussed environmental, social and governance (ESG) shareholder proposals, including trends in 2021 and 2022, the impact of SEC rule changes, investor relations best practices, strategy and goal setting during a webinar titled "ESG Shareholder Proposals — Practical Guidance From Proxy, Legal, IR and Consulting Perspectives" on January 6.

Watch the full recorded webinar.

Katten's Capital Markets Practice

Capital markets activity is subject to complex disclosure and regulatory requirements from multiple agencies. Pragmatic guidance on public and private financing transactions requires a multipronged perspective. Katten's work on thousands of securities matters keeps clients' capital-raising deals on track and governance practices sound. For more information, click here.

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