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Quarterly Survey of SEC Rulemaking and Major Court Decisions (January 1, 2024 – March 31, 2024)

By Kenneth M. Silverman and Kerrin T. Klein[*]

This issue's Survey focuses on the U.S. Securities and Exchange Commission's ("SEC") rulemaking activities and other decisions relating to the Securities Act of 1933, as amended (the "1933 Act"), the Securities Exchange Act of 1934, as amended (the "1934 Act"), and other federal securities laws from January 1, 2024 through March 31, 2024.

This quarter, the SEC proposed one new rule and approved nine final rules. In relevant part, the final and proposed rules continue the SEC's trend of increasing the scope of information available to investors. The highlights of this latest round of rulemaking are the changes to SPAC regulations and the hotly contested climate-risk disclosures, each described in detail below.

Final Rules

Rules Relating to SPACs, Shell Companies, and Projections

On January 24, 2024, the SEC adopted final rules designed to enhance disclosure requirements by special purpose acquisition companies ("SPACs") in their initial public offerings ("IPOs") and in subsequent business combination transactions between SPACs and their target companies ("De-SPAC Transactions").

These final rules are substantively the same as the proposed rules that the SEC issued in March 2022, except the SEC did not adopt (i) the proposed rules that would have deemed a SPAC IPO underwriter's participation in a De-SPAC Transaction to be liable as statutory "underwriters" under the 1933 Act and (ii) the proposed rule that would have created a safe harbor for SPACs under the Investment Company Act of 1940, as amended (the "Investment Company Act").

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Enhanced Disclosure Requirements

The final rules include a number of new disclosure requirements in connection with SPAC IPOs and De-SPAC Transactions.

Disclosure regarding SPAC sponsors

New Item 1603(a) of Regulation S-K will require a description of the SPAC sponsor's business, experience, material roles and responsibilities, and the existence of any agreements between the SPAC sponsor and the SPAC, its officers, directors or affiliates with respect to determining whether to proceed with a De-SPAC Transaction and the redemption of outstanding securities. In addition, Item 1603(a) will require disclosure related to any direct or indirect material interests that any controlling persons of the sponsor and any other persons may have in the sponsor. Also, there must be a description of the nature and amount of all compensation that has been or will be awarded to, earned by or paid to the SPAC's sponsor, its affiliates and any promotors.

Potential Conflicts of Interest

New Item 1603(b) of Regulation S-K will require disclosure of any actual or potential material conflicts of interest between a SPAC's sponsor or its affiliates, the SPAC's officers, directors or promoters or the SPAC's target company's officers and directors, on the one hand, and unaffiliated security holders of the SPAC, on the other. Further to this required disclosure, Item 1603(c) of Regulation S-K will require disclosure regarding the fiduciary duties that a SPAC's officers and directors owe to other companies.

Dilution

Prior to adoption of the final rules, SPACs were required to disclose estimated dilution as a function of the difference between the IPO price and the pro forma net tangible book value per share after the offering, which would often include an assumption of the maximum number of shares eligible for redemption in a De-SPAC Transaction. The final rules will now require additional specificity on the prospectus cover page by requiring SPACs to present redemption scenarios in quartiles up to the maximum redemption scenario. Further, the final rules supplement Item 506 of Regulation S-K by requiring SPACs to describe material potential sources of future dilution following a SPAC's IPO, as well as tabular disclosure of the amount of potential future dilution from the public offering price that will be absorbed by non-redeeming SPAC stockholders, to the extent quantifiable. Further, the final rules require additional disclosure regarding material potential sources of dilution as a result of the De-SPAC

Transaction in a tabular format that includes intervals of selected potential redemption scenarios that may reasonably occur.

Board Determination of a De-SPAC Transaction and Fairness Opinions

Codifying an already common market practice, if state law requires that a SPAC's board of directors determine whether a De-SPAC Transaction is advisable and in the best interests of the SPAC and its stockholders, then under new Item 1606(a) of Regulation S-K, SPACs will be required to disclose the board's determination. Even if not required under state law, it is common practice that SPACs provide statements from its board of directors regarding approval of a De-SPAC Transaction and recommendations to its stockholders on how to vote on such De-SPAC Transaction. In addition, if a SPAC's board of directors receives any outside opinion, report or appraisal that materially relates to the fairness of the SPAC's De-SPAC Transaction, the SPAC is required to disclose certain information about such opinion, report or appraisal, which has also become common practice.

Harmonizing De-SPAC Transactions with Traditional IPOs

In an effort to harmonize the disclosure requirements for De-SPAC Transactions with that of a traditional IPO, the SEC adopted certain rules that will make certain aspects of a De-SPAC Transaction similar to a traditional IPO.

Adding Target Companies as Co-Registrants

Prior to adoption of the final rules, only the SPAC and its officers and directors were required to sign the registration statement filed in connection with a De-SPAC Transaction and were liable for material misstatements or omissions contained in such registration statement. The final rules require the target company in a De-SPAC Transaction to be treated as a co-registrant with the SPAC when the SPAC files a Form S-4 or F-4 registration statement with the SEC in connection with a De-SPAC Transaction. This will extend liability for material misstatements or omissions to a target company and its officers and directors. Pursuant to the final rules, target companies and its officers and directors will be liable with respect to not just their own material misstatements and omissions, but also any material misstatements or omissions made by the SPAC or its officers and directors.

Smaller Reporting Company Status

Due to the typically limited public float and/or revenue of many

SPACs, such SPACs often qualify for smaller reporting company ("SRC") status for SEC reporting purposes. Registrants that qualify as an SRC are permitted to provide certain scaled-down disclosures in registration statements and periodic reports filed with the SEC and are afforded certain accommodations that other reporting companies do not necessarily enjoy. Prior to adoption of the final rules, if the SPAC was the survivor following consummation of a De-SPAC Transaction, such SPAC, and now combined company following a De-SPAC Transaction, was able to retain its SRC status until its next annual determination date following the De-SPAC Transaction. However, traditional IPO companies are required to determine their filer status at the time they file their initial registration statement with the SEC. To harmonize this difference between combined companies following a De-SPAC Transaction and traditional IPO companies, the final rules require combined companies to redetermine their filer status within four business days following consummation of a De-SPAC Transaction. The revenue threshold for determining filer status in this case must be determined by using the annual revenues of the target company as of the most recently completed fiscal year for which audited financial statements are available. The combined company must reflect its redetermined filer status in filings beginning 45 days following consummation of the De-SPAC Transaction.

Private Securities Litigation Reform Act of 1995 ("PSLRA")

The PSLRA provides a safe harbor for forward-looking statements under the 1933 Act and the 1934 Act, under which a company is protected from liability in any private right of action under the 1933 Act or 1934 Act when, among other things, the forward-looking statement is identified as such and is accompanied by meaningful cautionary statements. Under the PSLRA, the safe harbor is not available, however, when a forward-looking statement is made in connection with an offering by a "blank check company," which, prior to adoption of the final rule was defined as a development stage company with no specific business plan or purpose or has indicated that its business plan is to engage in a merger or acquisition with an unidentified company or companies, or other entity or person, and is issuing penny stock. Many practitioners took the position that a SPAC was not a "blank check company" for purposes of the PSLRA because a SPAC typically did not satisfy the penny stock prong of the definition provided above. Most SPACs would typically raise greater than $5 million in a firm commitment underwritten IPO, so SPACs would not be considered to be issuing penny stock under the definition. Thus, the final rules amend the definition of "blank check company" to remove the penny stock prong and effectively

eliminate a SPAC's ability to qualify for the PSLRA safe harbor provision.

Enhanced Disclosure Related to Projections

The final rules also adopted a new Item 1609 of Regulation S-K to provide for enhanced disclosure regarding financial projections used in De-SPAC Transactions. Such accompanying disclosure to financial disclosures must include: (i) the purpose for which the projection was prepared and the party that prepared the projection; (ii) the material bases of the disclosed projections and all material assumptions underlying the projections, including any material factors that may materially affect such assumptions; and (iii) a discussion of whether the projections disclosed continue to reflect the views of the board of directors and/or the management of the SPAC or target company, as applicable, as of the most recent practicable date prior to the date of the disclosure document required to be disseminated to security holders.

These new disclosure requirements regarding financial projections used in De-SPAC Transactions, accompanied with the elimination of the PSLRA safe harbor for SPACs described above, will likely create additional risk for SPACs and target companies, including its directors and officers, because they will no longer be able to rely on the PSLRA safe harbor in connection with financial projections. It is unclear at this time how SPACs and target companies will use financial projections in light of these new rules as they could result in significant liability if such financial projections or disclosure are shown to be an untrue statement of a material fact or omission of a material fact necessary to make the statement not misleading.

Further, under the final rules, the SEC also amended Item 10(b) of Regulation S-K to expand and update the use of projections in all SEC filings, not just De-SPAC Transactions. Item 10(b) now requires that (i) projections that are not based on historical results be clearly distinguished from projections that are based on historical results, (ii) projections based on historical results also present the historical results with equal or greater prominence, and (iii) projections that include non-GAAP measures include a clear definition of those measures, a description of the GAAP measure that is most directly comparable and an explanation as to why the non-GAAP measure is used instead of the GAAP measure. Prior to the adoption of the final rules, Item 10(b) of Regulation S-K referred to projections regarding the "registrant." The final rules clarify the SEC's guidance to note that any projections of future economic performance does not apply to just the registrant, but also applies to any persons other than the registrant, such as a target company in a De-SPAC Transaction, that are included in a registrant's filing.

Underwriter Liability

The SEC's March 2022 proposed rules included a proposal that would have deemed a SPAC's IPO underwriter that participates in the SPAC's De-SPAC Transaction to be a statutory underwriter for purposes of the De-SPAC Transaction. The SEC did not adopt this proposed rule and, instead, issued guidance on statutory underwriter status in a De-SPAC Transaction. If the SEC adopted the proposed rule, the rule would have expanded the potential liability to banks that provide services in a De-SPAC Transaction. Under the proposed rule, this liability would have extended to banks acting as a financial advisor for the SPAC or target company in a De-SPAC Transaction or a bank acting as a placement agent in connection with a private offering of securities as part of the De-SPAC Transaction. The proposed rule could have also extended liability to a SPAC IPO underwriter that receives a deferred underwriting commission upon consummation of the De-SPAC Transaction but was otherwise not involved in the De-SPAC Transaction in any capacity.

Pursuant to the SEC's guidance that was issued with the final rules, the SEC noted that where someone is selling for the issuer or participating in the distribution of securities in the combined company to the SPAC's investors and the broader public may be deemed a statutory underwriter. Depending on the facts and circumstances, such an entity could be deemed a statutory underwriter even though it may not be named as an underwriter in any given offering or may not be engaged in activities that are typical of a named underwriter in traditional capital raising transactions.

Investment Company Act

Prior to a De-SPAC Transaction, SPACs are not engaged in any meaningful business other than investing the proceeds it received from its IPO and searching for target companies. Due to this lack of meaningful business, SPACs could theoretically be deemed investment companies under the Investment Company Act of 1940, as amended (the "Investment Company Act"). The SEC's March 2022 proposed rules included a proposal to adopt a safe harbor that would exclude a SPAC from being deemed an investment company under the Investment Company Act. However, the SEC did not adopt the proposed safe harbor. Instead, the SEC provided guidance on activities that may raise concerns for SPACs as to investment company status. The test to determine investment company status will be based on a facts and circumstances analysis, and the factors to take into consideration are:

- **The Nature of a SPAC's Assets and Income**. The SEC noted that if a SPAC owns or proposes to acquire 40% or

more of its total assets in investment securities, such as corporate bonds, or a SPAC's income that is substantially derived from such assets could cause the SPAC to be deemed an investment company under the Investment Company Act. However, this should not be an issue for most SPACs because most SPACs' investments typically consist of U.S. government securities and U.S. registered money market funds.

- **Management Activities**. If a SPAC holds investment securities while its management team is not actively seeking to consummate a De-SPAC Transaction, or if a SPAC's officers, directors or employees are spending a substantial amount of time in managing the SPAC's investment portfolio to achieve returns and not actively seeking target companies to consummate a De-SPAC Transaction, such actions could increase the likelihood that a SPAC is deemed an investment company under the Investment Company Act.
- **Duration**. The longer the amount of time a SPAC has been operating prior to entering into an agreement with a target company and then consummating a De-SPAC Transaction, the more likely a SPAC could be deemed an investment company under the Investment Company Act. SPACs operating for more than 12 or 18 months should assess its investment company status because the SEC noted that Rule 3a-2 under the Investment Company Act provides a one-year safe harbor for "transient investment companies" and blank check companies under Rule 419 of the Investment Company Act are not deemed investment companies because their duration is limited to 18 months. The SEC's references to these rules seem to suggest that SPACs operating for more than 12 or 18 months should be cautious of being deemed an investment company.
- **Holding Out**. If a SPAC holds itself out as primarily engaged in the business of investing, reinvesting or trading securities, the SPAC will increase the likelihood that such SPAC will be deemed an investment company under the Investment Company Act.
- **Merging with an Investment Company**. If a SPAC proposes to consummate a De-SPAC Transaction with an investment company, the SPAC will increase the likelihood that such SPAC will be deemed an investment company under the Investment Company Act.

Practically, this guidance is not new for SPACs because typically SPACs are designed and managed to prevent any question of being deemed an investment company under the Investment Company Act. However, the one area that can create uncertainty

for SPACs is the duration aspect. It has generally become accepted in the market for SPACs to consummate a De-SPAC Transaction within 24 months following its IPO. However, as seen over the last few years in the market, SPACs have been pushing the limits of Nasdaq's and NYSE's rules that impose a 36-month time limit as a condition to being listed on those exchanges. In an effort to decrease the risk of a longer than expected duration, SPACs have moved the investments held in their trust account to cash once they reach that 12-month or 18-month period.

Effectiveness and Compliance

The final rules will become effective July 1, 2024. Compliance with the final rules will begin on July 1, 2024. Registrants will be required to tag information disclosed pursuant to subpart 1600 of Regulation S-K in Inline XBRL starting on June 30, 2025.

Clarifications to the Definition of "As Part of a Regular Business"

On February 6, 2024, the SEC adopted final rules to significantly broaden the definition of the phrase "as a part of a regular business" as used in the statutory definitions of "dealer" and "government securities dealer" under Sections 3(a)(5) and 3(a)(44) of the 1934 Act. Newly adopted Rules 3a5-4 and 3a44-2 set forth parallel qualitative standards designed to identify market participants who take on significant liquidity-providing roles and mandate such participants' registration under the 1934 Act as dealers or government securities dealers.

Out of stated concerns that non-broker dealers are increasingly playing an outsized role in providing liquidity in trading markets, the SEC first proposed Rule 3a5-4 and Rule 3a44-2 in March 2022 to provide that any person that engages in any of the following activities for its own account (meaning an account held in the name of that person or for the benefit of that person) as part of its regular business would be a "dealer" or "government securities dealer" that must register under the 1934 Act. The final rules prescribe two sets of tests that, if either is met, will qualify a party as a dealer or a government securities dealer. Under the first test, a party that regularly expresses trading interest (i.e., purchases securities) that are at or near the best available prices on both sides of the market for the same security and is communicated and represented in a way that makes it accessible to other market participants (the "Expressing Trading Interest Factor") may qualify as a dealer or government securities dealer. Under the second test, a party that earns revenue primarily from capturing bid-ask spread (by buying at the bid and selling at the offer), or from capturing any incentives offered by trading venues

to liquidity-supplying trading interests (the "Primary Revenue Factor") may also qualify as a dealer or government securities dealer.

The Expressing Trading Interest Factor test seeks to capture *de facto* market making activities conducted by the use of automated and high-frequency trading strategies that generate a large volume of orders and transactions. Here, the final rules define the concept of regularity based on daily trades that are made over a long period of time. This concept of regularity is designed to exclude market participants that express trading interest irregularly or on an intermittent basis. Reviews of market orders under the Expressing Trading Interest Factor include any firm indication of a willingness to buy or sell a security, including any bid or offer quotation, market order, limit order or other priced order, as well as any non-firm indication of willingness to buy or sell a security that identifies quantity, direction, or price in any manner. The final rules include activities that involve the buying or selling of cryptocurrency assets that are securities or government securities.

The Primary Revenue Factor is not a bright-line test and intends to capture market participants that primarily seek to earn revenue from bid-ask spreads or by utilizing liquidity incentives offered by a trading venue, rather than seeking appreciation based on speculative increases in value of the actual securities purchased. In this context, trading venues can include a national securities exchange, an alternative trading system, or other platform used for executing trading interests. Potentially implicated parties should note that the actual generation of revenue is not necessary for the Primary Revenue Factor to be applied, as a person who unprofitably engages in high-volume and frequency bid-ask spread trading or liquidity-incentive based trading may still be subject to registration under the final rule.

Absent an exception or exemption, market participants that meet either the Expressing Trading Interest Factor or the Primary Revenue Factor will be required to register with the SEC under Section 15(a) or 15C of 1934 Act, as applicable, become a member of a self-regulatory organization ("SRO") such as FINRA, and comply with federal securities laws, regulatory obligations and applicable SRO and rules and requirements. Exemptions to the application of Rule 3a5-4 and Rule 3a44-2 include persons that have or control assets under $50 million, investment companies registered under the Investment Company Act, or international financial institutions, including central banks and sovereign wealth funds.

The final rules became effective on April 29, 2024 and the compliance date is April 29, 2025. Parties implicated by these

rules should begin preparations to register with the SEC and FINRA in advance of the compliance deadline. The SEC identified up to 43 entities that may be required to register under the final rules based on data from the Trace Reporting and Compliance Engine (TRACE) and Form PF filings, though the ultimate number of impacted entities may be much larger.

Amendments to Form PF

On February 8, 2024, the SEC, in coordination with the Commodity Futures Trading Commission ("CFTC"), jointly adopted amendments to Form PF, the confidential reporting form for certain SEC-registered investment advisers ("Registered Advisers") to private funds, including those that are also registered with the CFTC as a commodity pool operator or commodity trading adviser. The SEC has been focused on updating Form PF over the last year, as this is the third set of amendments issued by the SEC to Form PF over the last year.

Form PF provides the SEC with confidential information about the basic operations and strategies of private funds and their advisers. The SEC noted that the final rules are designed to provide greater insight into private funds' operations and strategies, assist in identifying trends, including those that could create systemic risk, improve data quality and comparability, and reduce reporting errors. The key takeaways from the final rules are the amendments to reporting master-feeder arrangements and parallel fund structures, and amendments to the reporting of other information about Registered Advisers and their funds.

Amendments to Reporting Master-Feeder Arrangements and Parallel Fund Structures

Prior to adoption of the final rules, Registered Advisers were permitted to report master-feeder funds and parallel funds either in the aggregate or separately provided that they did so consistently throughout Form PF. Most advisers chose to take a reporting approach that was consistent with their internal reporting and recordkeeping. A master-feeder arrangement is an arrangement in which one or more funds ("feeder funds") invest all or substantially all of their assets in a single private fund ("master fund"). A parallel fund structure is a structure in which one or more private funds pursues substantially the same investment objective and strategy and invests side-by-side in substantially the same positions as another private fund.

The final rules require all Registered Advisers to report master-feeder arrangements and parallel fund structures on a disaggregated basis, and each component will need to be reported. However, disregarded feeder funds, which are funds that invest

all of their assets in a single master fund, U.S. Treasury bills, or cash and cash equivalents, may continue to be reported on an aggregated basis with their master fund. Registered Advisers will need to identify whether the feeder fund is a disregarded feeder fund and "look through" to the fund's investors when addressing certain questions regarding investors on behalf of any applicable master fund. The feeder fund will need to disregard any of its holdings in the master fund's equity for purposes of determining the feeder fund's reporting threshold.

Amendments to Reporting Information About the Registered Advisers and their Funds

The final rules also include amendments to Form PF to update or expand certain basic information related to all Registered Advisers and their private funds. Registered Advisers that advise hedge funds will be required to identify the strategy of each of its private funds and indicate whether such funds are an open-end private fund or a closed-end private fund. In connection with reporting assets under management attributable to certain private funds, Registered Advisers will be required to exclude the value of private funds' investments in other internal private funds to avoid double counting of assets. Registered Advisers will also be required to separately report the value of unfunded commitments that are currently included in each private fund's reported net and gross asset values. In addition, Registered Advisers will be required to report all new capital contributions, not reported since the prior report, from investors and exclude contributions of committed capital that were already included in the fund's gross asset value.

One of the more sensitive amendments under the final rules is the requirement to disclose more information regarding beneficial ownership of private funds. Registered Advisers will be required to disclose (1) whether beneficial owners of the private funds that are broker-dealers, insurance companies, nonprofit organizations, pension plans, banking or thrift institutions are U.S. persons or non-U.S. persons, (2) whether beneficial owners that are private funds are either internal or external private funds, and (3) a description of any investors included in the "other" category and why such investors would not qualify for any of the other categories. Registered Advisers will also be required to report performance as a money-weighted internal rate of return, instead of a time-weighted return, if the fund's performance is reported to investors, counterparties or otherwise as an internal rate of return since inception.

Effectiveness and Compliance

The final rules will become effective March 12, 2025. Registered

Advisers will be required to comply with the final rules starting on March 12, 2025.

The Enhancement and Standardization of Climate-Related Disclosures for Investors

On March 6, 2024, the SEC adopted new rules mandating climate-change related disclosures in public companies' annual reports and registration statements (collectively, the "Climate Change Rules"). The Climate Change Rules are likely to impose sweeping requirements that, among other things, will require registrants to disclose (i) climate-related risks on business strategy and future outlooks, (ii) climate-change mitigation or adaptation strategies, (iii) climate-related targets or goals, and (iv) climate-related risk oversight and governance. The final rules are largely composed of mandatory qualitative disclosures of climate-related risks under Regulation S-K through new subpart 1500 (Items 1500 to 1508) and financial disclosures under Regulation S-X through a new Article 14, though there are also new reporting requirements under Rule 436 of the 1933 Act. In general, registrants must assess and disclose the actual and potential material impacts of climate-related physical and transition risks on the registrant's strategy, business mode and outlook. Each set of rules is described in further detail below.

Regulation S-K Amendments

New Item 1501 establishes disclosures related to climate oversight and governance. Under Item 1501(a), oversight and governance processes related to climate risks that are utilized by the registrant's board of directors and management must be disclosed in annual reports on Form 10-K and 20-F, as applicable, as well as the registrant's processes to identify, assess and manage material climate-related risks. This requirement establishes that a registrant must provide disclosures relating to (i) any board committee or subcommittee established to oversee climate-related risks, (ii) a description of the process by which the registrant's board or such committee or subcommittee oversee climate-related risks, and (iii) whether and how the board oversees progress against climate-related targets. Item 1501(b) provides for similar disclosures related to management oversight of climate-related risks. Under both Item 1501 subparts, if a material climate risk is identified, a registrant must describe the internal process for identifying, assessing and managing such material climate risks as well as whether and how those processes are integrated into the registrant's overall risk management program.

Beyond board and management oversight mechanisms, new

Item 1503 requires registrants to disclose their activities to mitigate or adapt to material climate-related risks or use of a transition plan to manage a material transition risk, as well as any associated material expenditures incurred. It remains to be seen what mitigation or adaptation activities would ultimately warrant disclosure, but registrants should note that even planning for potential climate risks may necessitate separate disclosures under the final rules. Specifically, Items 1500 and 1502(f) provide that if a registrant uses scenario analysis to assess the impact of climate-related risks on its business, results of operations, or financial condition, and if, based on such scenario analysis, the registrant determines that such risks are reasonably likely to have a material impact, then the registrant must describe each scenario, including a brief description of the parameters, assumptions and analytical choices used in their annual reports on Form 10-K or 20-F filings, as applicable. Under any of the qualitative disclosure requirements mandated by the Climate Change Rules, companies need only disclose the general geography of assets and operations subject to such physical risks, a change from the proposed rules which sought to prescribe granular location disclosure, such as by zip code. In sum, planning and mitigation strategy disclosures under the Climate Change Rules are sweeping and may result in lengthy discussions among impacted registrants.

Under Item 1504, a registrant must disclose whether any climate-related target or goal has or is reasonably likely to materially affect the registrant's business, results of operations or financial condition. Like Items 1501 and 1503, disclosures under Item 1504 will apply to all registrants, including SRCs and emerging growth companies ("EGCs"). Disclosures under Item 1504 will be required to be updated on a yearly basis with descriptions of any progress made on previously disclosed targets or goals (including whether any milestones were achieved). Additionally, if a registrant uses any type of renewable energy credits or carbon-offset programs as a material component of its plan to achieve climate-related targets or goals, then, in addition to any related financial information required to be disclosed under the Regulation S-X amendments described below, the registrant will also be required to disclose, among other things, the cost, nature and source of any such energy credits or offset programs.

Among the more controversial provisions of the Climate Change Rules, under new Item 1505 large accelerated filers ("LAFs") and accelerated filers ("AFs") will need to make disclosures related to their pollution and emissions. In part, LAFs and AFs will be required to disclose material "Scope 1" and "Scope 2" greenhouse gas ("GHG") emissions as quantified data points. As used in the final rules and as defined by the U.S. Environmental Protection

Agency, Scope 1 GHGs include those emitted from sources that are directly controlled or owned by an organization and its directly owned assets, such as emissions associated with fuel combustion in company-owned vehicles or furnaces used in company facilities. Scope 2 GHGs may be considered "one step removed" from the primary party as being the result of indirect action that may include upstream activities such as those generated from leased assets, employee commuting, business travel, and purchased goods and services. The SEC did not include in the final rules the highly controversial section of the proposed rule that would have required disclosure of even-further removed "Scope 3" GHG emissions. As originally proposed in March 2022, LAFs would have been required to additionally disclose emissions from their own operations and emissions from the company's "value chain," which would have included all parties in the registrant's supply chain, such as service and parts providers, as well as any emissions likely to be generated from the disposal or use of the product by the end consumer. Further, Item 1505 features a materiality qualifier for Scope 1 and Scope 2 disclosures that was not part of the initial proposal. The final rule notes that registrants should apply "traditional notions of materiality" under securities laws, and that materiality is not determined strictly by the amount of said emissions but whether a reasonable investor would consider the disclosure important when making an investment or voting decision. This materiality carveout should provide comfort to registrants who may have been initially concerned with the potentially monumental burden of gathering and analyzing data for all GHG emissions.

A registrant that is required to report Scope 1 and Scope 2 GHG disclosures under Item 1505 must also include an attestation report covering such GHG disclosures in the relevant filing under new Item 1506. Only LAFs must comply with the higher burden of providing an attestation report at the reasonable assurance level, and even then, the requirement has a substantial phase-in period with the first report at that level being due for filings based on the fiscal year beginning in 2033. A limited assurance attestation report will be due for LAFs for filings based on the fiscal year beginning in 2029, with such reports coming due for AFs (other than SRCs and ECGs) in 2031. AFs will not be required to furnish reasonable assurance attestation reports under the final rules. In the adopting release, the SEC noted the prevalent practice of companies already seeking voluntary assurances of their GHG disclosures and likens the process to the necessity of provided audited financials in annual reports.

Financial Statement Disclosures

Regarding financial statement disclosures, the final Climate

Change Rules add a new Article 14 under Regulation S-K, requiring registrants (including SRCs and EGCs) to make certain financial disclosures related to climate risks under three different categories of information: (i) financial impact metrics, (ii) expenditure metrics, and (iii) financial estimates and assumptions. These new financial disclosures will be subject to audit by an independent auditor and fall within the regular scope of the registrant's internal control over financial reporting, and therefore would not be required in quarterly reports on Form 10-Q.

Article 14 mandates the disclosure of, among other things, charges and losses incurred by the registrant as a result of severe weather events and other natural conditions, subject to certain threshold requirements. For example, registrants will only need to disclose expenditures incurred and losses that exceed 1% of the absolute value of income or loss before income tax expense or benefit and capitalized costs and charges that exceed 1% of the absolute value of stockholders' equity or deficit. Similar to the geographic-sensitive nature of the Climate Change Rules' qualitative descriptions, here too the rule contemplates company-specific determinations of secure weather events that take into account historical experience of such events and the financial impact of the event on the registrant only. Article 14 financial disclosures do not need to be in a prescribed tabular format, but notes to financial impacts must be descriptive of the estimates and assumptions used when making reporting determinations.

The SEC scaled back the initially proposed financial reporting requirements in part by removing the proposal that would have required disclosure of revenue changes due to climate-related events and other financial impact metrics.

Safe Harbors and Timing

The final rules extend the safe harbor provided under the PSLRA under new Item 1507 to apply the statutory safe harbors provided thereunder to forward-looking statements (excluding historical facts) relating to transition plans, scenario analysis, the use of an internal carbon price, and targets and goals. This safe harbor will hopefully provide registrants with some assurance of protection against opportunistic plaintiffs' attorneys filing suits arising out of these new disclosures mandated by the Climate Change Rules. In particular, the safe harbor explicitly extends to registrants who would not otherwise enjoy the benefit of the PSLRA safe harbor for forward-looking statements, including IPO registrants and SPACs. However, the SEC declined to extend the PSLRA safe harbor to LAFs' and AFs' disclosures of Scope 1 and Scope 2 GHG emissions, taking the stance that such calculations are made using well-established methodology.

The final rules will be phased in for all registrants, with the compliance date dependent upon the status of the registrant as an LAF, an AF, a non-accelerated filer, SRC, or EGC, and the content of the disclosure. For LAFs, most Regulation S-K and S-X disclosures will first be due for filings in 2026 based off the fiscal year beginning in 2025. For AFs (other than SRCs and ECGs) the first disclosures under the new rules will be for filings in 2027 based on reporting from the fiscal year beginning in 2026. SRCs, ECGs, and non-accelerated filers will begin their first reporting under the new rules in 2028 based on data from the fiscal year beginning in 2027. Certain other disclosures, namely the Scope 1 and Scope 2 GHG emissions information required under Item 1505 have a longer phase-in as mentioned above, with the first reporting due in 2027 for LAFs and 2029 for AFs other than SRCs and EGCs.

The final rules do not preclude incorporation by reference from a registrant's proxy statement to the extent allowed by existing rules, but the SEC declined to expressly permit the disclosure to be incorporated by reference from a registrant's proxy statement pursuant to General Instruction G.3 of Form 10-K.

Controversy

Perhaps anticipating robust legal challenges, the SEC dedicated an unusually large section in the final rule release outlining the SEC's purported authority to promulgate the Climate Change Rules by preemptively rebutting likely arguments by opponents, such as those under the non-delegation and major-questions doctrines. Shortly after the final rules were announced, the SEC received nine petitions contesting its provisions from six different U.S. Circuit Courts. On March 15, 2024, the U.S. Court of Appeals for the Fifth Circuit granted an administrative stay on the Climate Change Rules based on a petition filed by certain oil field service companies that was later lifted on March 22, 2024. Those challenges have since been consolidated into one venue, with the U.S. Court of Appeals for the Eighth Circuit set to hear the challenges following a random drawing. On April 4, 2024, the SEC announced that it was voluntarily delaying implementation of the Climate Change Rules while the consolidated case is pending.

Disclosure of Order Execution Information

On March 6, 2024, the SEC adopted amendments to the disclosure requirements of Rule 605 of Regulation National Market System ("Regulation NMS") under the 1934 Act to expand the scope of reporting entities subject to the preexisting rule that required any exchange market, OTC market maker, alternative trading system, national securities exchange, or national securi-

ties association (collectively "market centers" as used in Regulation NMS) to make available to the public monthly execution quality reports to encompass broker-dealers with a larger number of customers and to modify the definition of a "covered order" to include certain orders submitted outside of regular trading hours and certain orders submitted with stop prices. Additionally, the final amendments modify the information required to be reported under Rule 605, including changing how orders are categorized by order size and order type, in part to capture execution quality information for fractional share orders, odd-lot orders and larger-sized orders.

Rule 605 was first adopted in 2000 with the goal of helping the investing public compare and evaluate execution quality among market centers. Since its implementation, Rule 605 has been a key rule for securities exchanges and those seeking insight into trade execution data. Prior to these amendments, reports under Rule 605 contained three primary categories for the determination of execution quality metrics: (i) the individual security traded, (ii) order type (five possible order types), and (iii) order size (four possible order sizes). Within each of those three categories, reports under Rule 605 required further statistics that included information about the total number of orders submitted, and the total number of shares submitted, shares canceled prior to execution, shares executed at the receiving market center, shares executed at another venue, shares executed within different time-to-execution buckets, and average realized spread. Rule 605 has not been substantively updated since its adoption and in the interim equity market conditions have changed due in part to many technological advancements that have altered the speed and nature of trading.

As amended, Rule 605 expands the scope of entities that must produce reports to include broker-dealers that introduce or carry 100,000 or more customer accounts that make any transactions in NMS stocks. Additionally, the amendments will require broker-dealers operating a single-dealer platform or an NMS alternative trading system to calculate and display statistics for orders entered into the platform or routed to the alternative trading system separately from other orders. The scope of "covered orders" under Rule 605 has also been expanded by the new amendments, requiring reporting of certain non-marketable limit orders submitted outside of regular trading hours if they later become executable during regular trading hours. Prior to these amendments, Rule 605 only required reporting of orders received during regular trading hours.

Regarding the information to be furnished in Rule 605 reports, the amendments expand the scope of information addressing exe-

cution quality to include the execution quality of fractional share orders, odd-lot orders and orders of 10,000 shares or more (which was previously explicitly exempted from reporting requirements). Six major new statistical measures of execution quality are now required in a summary report in both.CSV and.PDF formats to be published and made publicly available. Among other requirements, these statistical measures include (i) "E/Q" (the average effective spread divided by the average quoted spread), (ii) effective and realized spread statistics, (iii) size improvement benchmarks, and (iv) price improvement statistics. Furthermore, the amendments require that the time of order receipt and time of order execution be measured in increments of a millisecond or finer, and that realized spread be calculated at multiple time intervals.

The rule received a rare unanimous vote from all five SEC commissioners. The final rules will become effective 60 days after publication in the Federal Register with a compliance date 18 months thereafter.

Exemption for Certain Investment Advisers Operating Through the Internet

On March 27, 2024, the SEC adopted amendments to Rule 203A-2(e) under the Investment Advisers Act of 1940, as amended (the "1940 Act") to modernize the rule that exempts Internet investment advisers from the prohibition on SEC registration for smaller investment advisers. Currently, investment advisers are generally prohibited from SEC registration unless they surpass $100 million in assets under management or advise a registered investment company (or otherwise qualify for an exemption under SEC rules or statute). Internet advisers are exempt from this prohibition under Rule 203A-2(e) if they meet certain conditions, including those relating to the adviser's use of an interactive website to advise clients.

Now, with these amendments to Rule 203A-2(e) advisers that rely on the Internet adviser exemption must always provide investment advice to all of clients exclusively through an "operational" interactive website. Advisers relying on the exemptions must only have online clients going forward, as the final amendments eliminate the *de minimis* exception under the prior rule that permitted Internet advisers to have a limited number (i.e., fewer than 15) of non-Internet clients in the preceding 12-month period. Additionally, the amendments update the requirements of Form ADV to require an adviser relying on the Internet adviser exemption as a basis for registration to represent on Schedule D of its Form ADV that, among other things, it has an operational interactive website. For the purposes of this final

rule, the SEC renames the previously used defined term "interactive website" as "operational interactive website" to mean a website, mobile application or similar digital platform through which an investment adviser provides digital investment advisory services on an ongoing basis to more than one client (except during temporary technological outages of a *de minimis* duration).

These recent amendments to Rule 203A-2(e) follow the SEC's recent trends to modernize the regulatory regime monitoring investment advisers and build on the SEC's proposals from July 26, 2023 seeking to require investment advisers and broker-dealers to address conflicts of interest related to certain "covered technologies". In effect, this final rule will narrow the previously existing Internet exemption. The final rule and Form ADV amendments must be complied with starting on March 31, 2025. Advisers that may no longer rely on the Internet adviser exemption and do not otherwise have a basis for SEC registration must withdraw their SEC registration by June 29, 2025.

Proposed Rules

SEC Proposes Rule to Update Definition of Qualifying Venture Capital Funds

On February 14, 2024, the SEC proposed an amendment to Section 3(c)(1) of the Investment Company Act to update the dollar threshold for a fund to qualify as a "qualifying venture capital fund" for the purposes of the Investment Company Act. Proposed Rule 3c-7 would increase the dollar threshold of aggregate capital contributions and uncalled committed capital that a fund may raise from $10 million to $12 million. The $12 million dollar figure is based on the Personal Consumption Expenditures Chain-Type Price Index ("PCE Index"). The SEC routinely has used the PCE Index in similar contexts in other rules and provisions of federal securities laws. Proposed Rule 3c-7 would establish a process for future inflation adjustments every five years by specifying the PCE Index (or any successor index) as the inflation index used to calculate future adjustments to the dollar threshold to determine a qualifying venture capital fund.

The Economic Growth, Regulatory Relief, and Consumer Protection Act of 2018 (the "EGRRCPA") first amended the definition a qualifying venture capital fund under the Investment Company Act to add the definition that a qualifying fund must have less than $10 million in aggregate capital contributions and uncalled committed capital. Section 504 of the EGRRCPA set forth the requirement that the SEC index the dollar figure for a qualifying venture capital fund once every five years, so it is likely that this marginal increase will not generate much

controversy or surprise among impacted entities. The comment period for the proposed rule closed on March 22, 2024.

Recent Federal Court Decisions

District Court for the District of Columbia Holds "Proxy Voting Advice" is Not Solicitation

On February 23, 2024, the United States District Court for the District of Columbia vacated a SEC rule, codified at 17 C.F.R. § 240.14a-1(l)(1)(iii)(A), that amended the definition of the terms "solicit" and "solicitation" in connection with Section 14(a) of the Securities Exchange Act of 1934 (the "Exchange Act") to include the furnishing of proxy voting advice for a fee. Section 14(a) of the Exchange Act makes it unlawful to solicit proxies pursuant to the U.S. Securities and Exchange Commission's (the "SEC's") rules and regulations, but does not define the term "solicit." The Court held that proxy advisory firms do not "solicit" proxies within the plain meaning of Section 14(a). As such, the Court held that the SEC acted "contrary to law and in excess of statutory authority" by defining the terms "solicit" and "solicitation" in the proxy rules to include proxy voting advice for a fee. The Court thus granted Plaintiff's motion for summary judgment and vacated the SEC's amendment to the rule.

Plaintiff Institutional Shareholder Services, Inc. ("Plaintiff") is a proxy advisory firm who brought suit against the SEC. Before the Court were motions for summary judgment, which included briefing by Plaintiff, the SEC, and intervenor-defendant National Association of Manufacturers ("NAM") regarding the meaning of "solicit" and "solicitation." After holding that Plaintiff's suit was not moot and its claims were ripe for adjudication, the Court conducted an analysis of the definitions and uses of the terms "solicit" and "solicitation." The District Court resolved the question regarding those definitions using the first step of the *Chevron* doctrine, since it held that Congress unambiguously expressed its intent regarding those terms. According to the Court, while Congress did not define the term "solicit" in Section 14(a) of the Exchange Act, the ordinary meaning of "solicit" at the time of the Exchange Act's enactment, as well as the history and purpose of Section 14(a), make clear that the definition did not include proxy voting advice for a fee. Such proxy advisors lack a financial or governance interest in a vote's outcome, and their advice is not public but rather given to investors who hire the firm for a fee. Thus, the District Court for the District of Columbia held that the SEC acted contrary to law and in excess of statutory authority by defining the terms "solicit" and "solicitation" in the proxy rules to include proxy voting advance for a fee. The Court thus

granted Plaintiff's motion for summary judgment and vacated the SEC's definitional amendment codified at 17 C.F.R. § 240.14a-1(l)(1)(iii)(A).

Institutional Shareholder Services Inc. v. SEC, case no. 19-cv-3275 (APM), in the U.S. District Court for the District of Columbia. The SEC filed an appeal of that decision to the United States Court of Appeals for the District of Columbia Circuit.

Apple Perseveres in Southern District of New York Against Shareholders' Executive Compensation Suit

On February 7, 2024, the United States District Court for the Southern District of New York granted a motion to dismiss claims brought against Apple Inc. ("Apple") and its officers and members of its Board of Directors (together, "Defendants"), asserting violations of Section 14(a) of the Exchange Act and regulations promulgated under the Exchange Act. The Court's decision rejected the bid by Plaintiff International Brotherhood of Teamsters, Garage Employees Local 272 Labor Management Pension Fund ("Plaintiff") to hold Defendants liable for claimed misstatements relating to executive compensation in Apple's proxy statement.

Plaintiff asserted three claims against Defendants. First, Plaintiff brought a cause of action pursuant to Section 14(a) of the Exchange Act relating to an Apple advisory, non-binding "Say-on-Pay" vote on executive compensation. Plaintiff alleged that the amount of executive compensation in the proxy statement's "compensation-narrative section"—$77.5 million in each of 2021 and 2022—understated the actual compensation disclosed amount in its "compensation-tables section"—approximately $92.69 million for 2021 and $94 million for 2022. The Court held that Apple's compensation proposal was "non-binding and advisory," and Plaintiff thus failed to plead any loss causation. The Court further held that Plaintiff did not plead any actionable misrepresentations. The Court held that there is no rule requiring that a specific method be used to calculate executive compensation, so long as the chosen method is disclosed. Since the proxy disclosed that information, there was no actionable misstatement.

Second, Plaintiff brought a cause of action pursuant to Section 14(a) of the Exchange Act relating to a proposal for the reelection of Apple's Board of Directors. The Court rejected this claim too, holding that Plaintiff failed to allege that Apple's Board of Directors "would not have been re-elected if the named executive officers' compensation was calculated differently."

Third, Plaintiff brought a derivative claim to recover excess compensation from Apple's officers. The Court held that Plaintiff

failed to meet the pleading standards of Fed. R. Civ. P. 23.1, because Plaintiff's arbitrary 14-day deadline was not a "reasonable time" for the Board to investigate and respond to Plaintiff's demand. The Court also held that Plaintiff failed to plead that the Board acted unreasonably or not in good faith.

International Brotherhood of Teamsters, Garage Employees Local 272 Labor Management Pension Fund v. Apple Inc. et al., case no. 1:23-cv-01867 (JLR), in the U.S. District Court for the Southern District of New York.