// INSIGHTS

The Corporate & Securities Law Advisor

VOLUME 36, NUMBER 12, DECEMBER 2022

PROXY SEASON POINTERS

The All-Purpose Proxy Statement? 3
Bob Lamm

2023 Proxy Season: What to Think About 4
Judy Mayo

Diversity Disclosure Trends 8
Kerry Burke, David Engvall, Matt Franker, David Martin and Will Mastrianna

Shareholders Are Looking for Alignment Between Your ESG Disclosures and Political Spending 9
June Hu

Universal Proxy: Five Takeaways and Five Action Items 11
Jurgita Ashley and Julia Miller

Pay-versus-Performance Disclosure FAQs 12
Cam Hoang and Dale Williams

SEC RULEMAKING

SEC Adopts Final Rules Mandating Compensation Clawback Policies 19
Joshua A. Agen, Jessica S. Lochmann, Leigh C. Riley, John K. Wilson and Samuel J. Winer

DRAFTING TIPS

A Few Etiquette Tips for Corporate Attorneys in Dealing with Other Attorneys 25
Andrew Abramowitz

THE STATE OF DISCLOSURE

Not Only Too Long but Sometimes Too Convoluted: The Perplexing State of Modern Securities Law Disclosures 26
James A. Deeken

Wolters Kluwer
www.WoltersKluwerLR.com

INSIGHTS

The Corporate & Securities Law Advisor

Editor-in-Chief
BROC ROMANEK
broc.romanek@gmail.com

EDITORIAL ADVISORY BOARD

ALLISON HANDY
Perkins Coie (Seattle)

AMY WOOD
Cooley (San Diego)

BRIAN BREHENY
Skadden, Arps, Slate, Meagher & Flom (Washington DC)

BRYAN BROWN
Jones Day (Houston)

CAM HOANG
Dorsey & Whitney (Minneapolis)

DAVID THOMAS
Wilson Sonsini Goodrich & Rosati (Palo Alto)

ERA ANAGNOSTI
White & Case (Washington DC)

HILLARY HOLMES
Gibson Dunn & Crutcher (Houston)

JACKIE LIU
Morrison & Foerster (San Francisco)

JOHN MARK ZEBERKIEWICZ
Richards Layton & Finger (Wilmington)

JURGITA ASHLEY
Thompson Hine (Cleveland)

KERRY BURKE
Covington & Burling (Washington DC)

LILY BROWN
WilmerHale (Washington DC)

LYUBA GOLSTER
Weil Gotshal & Manges (New York City)

MELISSA SAWYER
Sullivan & Cromwell (New York City)

NING CHIU
Davis Polk & Wardwell (New York City)

SABASTIAN NILES
Wachtell Lipton Rosen & Katz (New York City)

SARAH FORTT
Latham & Watkins (Austin)

SCOTT KIMPEL
Hunton Andrews Kurth (Washington DC)

SONIA GUPTA BARROS
Sidley Austin (Washington DC)

VICKI WESTERHAUS
Bryan Cave Leighton Paisner (Kansas City)

EDITORIAL OFFICE
28 Liberty Street,
New York, NY 10005
212-771-0600

Wolters Kluwer
Richard Rubin, Publisher
Jayne Lease, Managing Editor

INSIGHTS (ISSN No. 0894-3524) is published monthly by Wolters Kluwer, 28 Liberty Street, New York, NY 10005. To subscribe, call 1-800-638-8437. customer service, call 1-800-234-1660 or visit www.wolterskluwerlr.com.

For article reprints and reprint quotes contact *Wrights Media* at 1-877-652-5295 or go to *www.wrightsmedia.com.*

This publication is designed to provide accurate and authoritative information in regard to the subject matter covered. It is sold with the understanding that the publisher is not engaged in rendering legal, accounting, or other professional services. If legal advice or other professional assistance is required, the services of a competent professional person should be sought.

—From a *Declaration of Principles* jointly adopted by a Committee of the American Bar Association and a Committee of Publishers and Associations.

www.WoltersKluwerLR.com

THE STATE OF DISCLOSURE

Not Only Too Long But Sometimes Too Convoluted: The Perplexing State of Modern Securities Law Disclosures

By James A. Deeken

In the maze of every expanding disclosure in securities offering documents, a basic tenet is at risk of being lost: It is always easier to get someone to read something short than something that is long. There are counters to the benefits. A shorter document has less in and to the extent that omitted material is important, there is a cost to a short document.

However, a longer disclosure also has a cost as well in that few people in a certain segment of the target audience might actually read it. In addition, a long document can obscure important disclosure in that especially material information can be "drowned out" and not noticed when it is encompassed with pages and pages of boiler plate language. What is also ironic is that lengthy disclosures sometimes miss fundamental items of importance despite their length.

At a time when the Securities and Exchange Commission (SEC) is considering new disclosure requirements and also enhanced investor protections, there is a fundamental tension and question that is worthy of consideration. Is it better to have (1) a shorter document that has less in it but more people are likely to read or (2) a longer document that has more in it but that fewer people are likely to read and that might actually obscure important disclosures?

James A. Deeken *is a law partner at Akin Gump Strauss Hauer & Feld LLP and an adjunct lecturer at SMU's Dedman School of Law.*

A Longer Document or a Shorter Document?

It is a difficult question that lacks a simple answer. There is no "one size (one length) fits all" approach. There is no one type of homogeneous audience for a securities offering document. There are generally two types of audiences that a securities disclosure has: (1) a "retail" audience consisting of individual investors; and (2) an institutional investor audience consisting of investment funds, insurance companies, pension plans and other large financial institutions.

A random survey of randomly selected prospectus has an average length, excluding F pages, of 184 pages long.[1] If you assume that it would take an investor 60 seconds to read and digest a page of a prospectus that would generate a three-hour reading time. Keep in mind that this excludes the F pages. Is it reasonable to assume that an analyst at an institutional investor would spend three hours reviewing and a prospectus? That would not be an unreasonable assumption. Although that is certainly not universally the case.

I am confident in saying that most retail investors would not be inclined to read through a 184 page long small type prospectus. Perhaps it would have been likely 30 years ago. Although I suspect very unlikely even then. However, in today's modern world with work schedules spilling into evenings and weekends, constant bombardment of emails, text messages and social media and consistently available streaming, there is "always something on" and always something going on. I venture that most typical retain investors don't have a three-hour block of

solitude to read anything let alone either the time or motivation to slug through a dense prospectus.

It wasn't always this way. The first initial public offering that I worked on as a securities lawyer in 2001 had a prospectus that was 88 pages long, largely due to the size of the issuer, and that was at the long end of range. Over the years, securities disclosures have had their growth fed by expanding risk factor disclosures and by Securities and Exchange Commission guidance requiring more in-depth disclosure. Presently, there are pending considerations for requiring additional pages of information related to various social benefit metrics.

Risk factors are a particular area where disclosure has become over-written and convoluted. The disclosures have gotten longer over the years as issuers piggyback on new risk factors that other issuers originate. We are left with a growing Christmas tree that never gets shorter and only grows in size. Securities practitioners will often start with a set of risk factors from another recent offering and add to them when preparing a prospectus.

The situation is made worse by the growing escalation of "stock" risk factors that seem to form the stem of any starting point for risk factor disclosure. Each time there is a new disaster or negative event in the world it seems like it leads to a new risk factor, at times with no or questionable benefit. For example, it is really necessary that a number of public issuers now have a generic COVID risk factor that is not already covered by more general risk factors? We may get arid of COVID someday but will never get rid of the new risk factor that a pandemic or health crisis may negatively impact a company that seems to be becoming standard for many issuers. Risk factors that generically apply to businesses generally do little to add any real insight about a company's meaningful risks, especially when they may already overlap with broader risk factors. Some of this risk factor hoarding is driven by a tendency to mimic other disclosures.

The tendency is also not helped by the need that some securities counsel feel to practice "preventative medicine" to error to on the side of the disclosure of excess risk factors to foil an ever aggressive plaintiffs' bar. Modern risk factor practices have a lot to do with litigation prevention instead of meeting the original goal of risk factors, which was to inform prospective investors about the practical or unique risks that an issuer may face.

The result is that it is hard for an investor to tell what the real practical risks are. The most material risks are drowned out by pages of boiler plate and theoretical risks. A general rule of thumb that could be followed is that if you have bad news to disclose, disclose a lot of other information too so the bad news part does not stand out. When I started my practice in 1999, I heard of one issuer that was criticized for having too many risks factors in their prospectus. That issuer had about 35 risk factors.

In contrast, a review of the same recent prospectuses reveals that they contain an average of 66 separate risk factors. Sixty-six risk factors sound daunting by its very nature, but that is before considering that a number of these "risk factors" are several paragraphs long and address a number of sub-risks. With 66 risk factors, there could be two or three absolutely horrendous ones buried in the "middle of the stack" that don't get adequately noticed in the context of being surrounded by pages and pages of more mundane, routine ones. The inordinate number of risk factors makes it challenging for even the most sophisticated financial investor to sort through. I would go further and suggest that it is impractical to think that most retail investors could sort through that number of risk factors in an attempt to sort the wheat from the chaff, or the most practical and material ones from the boilerplate ones.

The plain English rules that the SEC adopted in 1998 were intended to make the disclosure in prospectuses simple, easier to understand and thus more likely to be read. Given the current state of disclosure offering documents it is hard to view them as a complete success. Even though it would be easy to conduct, has the SEC ever done a study on what percentage of retail investors have read a prospectus before investing? Alternatively, has a study ever been done showing what percentage of retail investors

© 2022 CCH Incorporated and its affiliates. All rights reserved.

have read any part of a relevant prospectus before making an investment decision?

It is time that we rid ourselves of the unrealistic assumption that retail investors have either the time or the patience to wade through 184 pages of densely written prose. There is a substantial risk that we as a securities legal industry are creating tomes whose main reading audience is not investors, but the lawyers who write them as issuers counsel and the lawyers on the plaintiff's side who try later to pick them apart when and if the issuer's stock price crashes.

We may very well be at a point where we need to consider adjusting securities disclosures for two separate audiences: (1) disclosure for the average retail investor; and (2) disclosure for institutional investors who might actually read through the voluminous disclosure in prospectuses. Although there may be a number of different approaches on how to take into account the different audiences and the practical realities laid out above, one possible approach would be to retain the current prospectus construct but to supplement it with a free-standing form of summary disclosure.

A Possible Shorter Disclosure with Better Information

Does the current summary section of the prospectus, that is, the "box," already effectuate the summary disclosure goal? In a way it does, but when it is folded into a longer document, the sheer "weight test" of the entire document certainly makes it less likely that a retail investor will crack the cover. Secondly, many of the current summaries seem to miss crucial information that might be buried back in the rest of the prospectus, if disclosed at all. Lastly, many of the current summaries are littered with opinions and sales promotion information that obscures the disclosure of basic important facts.

It is well worth considering a short summary document that would accompany a prospectus, either in printed form or accompanying electronic form that would address the items below, the size of which could likely be limited to 5 to 10 pages.

- *What does the issuer do*: Something very simple that is no longer than two sentences. The problem with a lot of the equivalent disclosure in prospectuses is that it is mixed with opinionated statements about the issuer's business that make the actual disclosure confusing. For example, most of them tend to say in the first few lines explaining what they do that they are the "leading," "premier," they have the "next generation" or related statements.

This short section would prohibit any opinions and instead require a short description of what the company actually does. Opinions can be distracting from a reader's understanding of an issuer factually does, especially when strong opinions are interjected when the business of the company is first described. The point would be that before getting into trying to sell the company, start by just neutrally explaining what the issuer does in plain English terms. To the extent that technical terms are used in a description of business, which are often seen in the context of life sciences or technology companies, those terms could be explained in a few non-technical phrases before being used repeatedly throughout a prospectus.

- *How does it make money*: A very simple disclosure statement that says how the issuer receives revenue in connection with the goods or services that it provides. This is currently scattered about in different portions of a prospectus, but would be clearly stated here.
- *Who are its major customers*: For issuers with a concentrated customer base, this could include some customers by name or those with disbursed customer bases, the types of customers.
- *What competitors does it have?* What barriers to entry are there for new competitors emerging? Do any competitors have known material advantages? These questions address the long-term business viability of the company. Yet, while there are references to competition in most prospectuses, usually sprinkled in risk factors and potential certain portions of Management's Discussion and Analysis and the Business sections, there is no one succinct

portion of most prospectuses that addresses these fundamental business issues in a succinct, upfront (as opposed to being risk factor #34, for example) manner.

- *Does the issuer rely on any key suppliers or supplies*? Are there any particular risks of cost or availability of supplies rising? Similar to the foregoing, there may be references to these items in risk factors, in the MD&A and the Business sections of a prospectus, but there is often no cohesive, upfront disclosure that addresses this business item that may be of extreme relevance for many issuers.
- *What are the top five risks the company faces*? This would be the issuer's determination and a cross reference could be made to the pages and pages of risk factors in the accompanying prospectus. The point of this disclosure would be to pull out the five most important risks so that investors could notice and understand them, rather than having them buried in a 25 page long fine print risk factor section in a prospectus. Certainly, there would be some fear that selecting only five risk factors would leave the company open to liability claims. For the risk factor selection to work effectively and in a manner that is fair to the issuer, liability protections would need to be extended to the issuers in this regard, as long as there is an appropriate cross reference to the risk factors in the prospectus.
- *How does management compensation create different incentives on the part of management that might conflict with stockholder interests*? The Executive Compensation section of prospectuses goes into great detail describing what executive compensation exists. This component would describe to what extent executive compensation might create incentives that might conflict with those of stockholders. For example, if management can exercise options with a strike price lower than that paid by investors by investors in the applicable securities, does that create any misalignment of interests? A number of issuers might conclude there are no conflicts with the particulars with their executive compensation practices, but in some cases, there may be conflicts that are worth highlighting in summary fashion.
- *What relationships do independent members of the board of directors (or equivalent governing body) have with the company leaders/founders*? This would be the issuer's disclosure as to whether there are any relevant relationships, notwithstanding that the independent directors meet the requisite legal requirements for independence.
- *To what extent are related party transactions and how might they impact the company*. While the prospectus would disclose these transactions in great detail, this item would entail disclosing in a few sentences the nature of any transactions and then in another few sentences describe the impact on, or general risks to, the issuer arising from such transactions, accompanied by a cross reference to the longer prospectus disclosure.
- *Who are the major stockholders and what control over the issuer will they have post-offering*? While some of this information is in the Description of Securities section of a prospectus, this item would be disclosure in summary fashion addressing who or what group effectively controls the issuer post-offering.
- *Are there any major liabilities or risks of litigation*? While this would cross reference to various sections of the prospectus for further information, this item would disclose in one place succinctly any pending or possible liabilities.
- *What is the current and anticipated capital structure of the issuer*? To the extent there is preferred stock or debt that may limit dividends on the class on securities being offered, this item would highlight that. With possible cross reference to Management's Discussion and Analysis of Financial Condition and Results of Operation, or MD&A, this item would also disclose any upcoming debt or large payments becoming due and the issuer's plans for payment related thereto.

© 2022 CCH Incorporated and its affiliates. All rights reserved.

Further Steps

Regardless of the idea for a summary document or not, the exercise of considering the various items may act as a "cleansing" exercise. The consideration may serve as a step back to realize that material elements of disclosure are lost and scattered around an average of 184 pages of fine print. At times, the important matters are "lost in the detail." Is the function of securities disclosure to provide helpful, practical disclosure to investors? If that is the goal, then the current standards for disclosure seem to fail as they rely upon unrealistic expectations about the amount of time that an investor will expend reading a fine print prospectus.

The current standards allow material details to be surrounded by and encompassed by disclosure of a more boilerplate nature. At the same time, Form S-1 and the incorporated sections of Regulation S-K, do not provide for issuers to draw out in one place important matters to be succinctly summarized in a coherent manner. Rather materials items are often disclosed piecemeal through a lengthy prospectus document that requires an investor to "hunt and peck" for all related items of disclosure.

In the current form, it seems that the primary de facto role of a prospectus is to be a legal risk management document, rather than to be a useful investor disclosure document. Separate from any suggestion to create a useful summary document, proactive steps could be taken to make prospectuses better:

- Apply scrutiny to any proposals to add further disclosure requirements to prospectuses. If the information is desirable for a social benefit effect on the theory that having the information available to the press and public sources puts needed "sunlight" on certain issues, consideration should be given to requiring that information to be disclosed in Part II of Form S-1, rather than Part I of the form. That way the information is out there, but no further length is added to prospectuses where are already too long.
- Consider ways to shorten current disclosures. Some of this could be done by revising regulations but a lot of it could be done informally. For example, the SEC staff in reviewing registration statements could consider working with issuers to reduce duplicative disclosure and to apply summaries disclosures that tie various items together.
- Focus groups of investors have the potential to yield suggestions to make prospectuses more readable and possibly more succinct. There is little reason to consider the nature of disclosure requirements without input from retail end-user readers, who don't always write comment letters on proposed SEC rule changes. The views of typical readers could go a great way towards supplementing the views that the SEC normally hears.
- Although it would be an ambiguous exercise, consideration could be given to whether the very technical MD&A section could be rewritten to bring together coherent themes and be more succinct. An average reader might get lost in the line-by-line narrative of why certain metrics changed from year to year, which constitutes much of MD&A. Someone without an accounting background may find themselves confused by discussions of items related to "gross margin," "deferred expenses," "accrued liabilities," and "revenue recognition." MD&A may do a good job at great length of painting a picture that helps a reader see the trees in the forest, but without in all cases presenting a clear view of the forest itself. Even when a normal reader can see the trees, in this case the detailed analytics, unless they have a sophisticated financial background they might not appreciate what they are seeing.
- Lastly, although it would difficult to enact, consideration should be given with respect to whether liability protections under securities offering documents could be enhanced without exposing investors to additional risk. The goal would be to find ways to reduce the perceived

needed of issuers to practice "preventative medicine" by adding voluminous disclosure, which in many cases may only be added with the goal with the intent of defending against a lawsuit later. The over-arching goal would be to help transform something that in its current form is a legal risk management document into something that is primarily a reader friendly disclosure document, consistent with the original intent of the Securities Act.[2]

Notes

1. KinderCare Learning Companies, Inc. (170); Sweetgreen, Inc. (225); Nu Holdings Ltd. (332); HashiCorp., Inc. (205); SONO GROUP N.V. (198); FinWise Bancorp (188); Sidus Space Inc. (87); Fresh Vine Wine, Inc. (86); Braze, Inc. (166).
2. A slightly different version of this article was originally published as "More is Better?: Concerns on the Growing Amounts of Securities Disclosure in Offering Documents and Public Filings," *Securities Law Regulation Journal*, Vol 50:2 2022. Reprinted in part from *Securities Regulation Law Journal*, with permission from Thomson Reuters. Copyright © 2022. Further use without permission of Thomson Reuters is prohibited. For further information about this publication, please visit:*https://legal.thomsonreuters.com/en/products/law-books*, or call 800.328.9352.

© 2022 CCH Incorporated and its affiliates. All rights reserved.