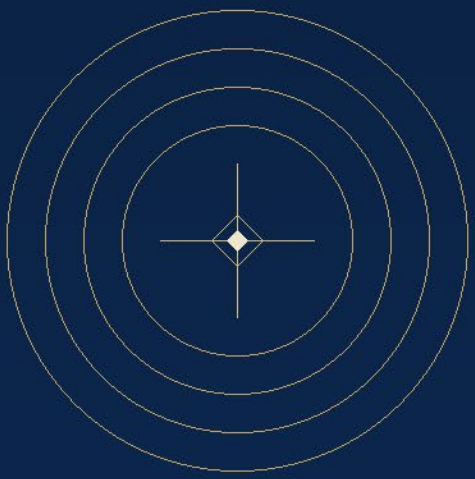
FOREIGN TRAINED LAWYERS ASSOCIATION

LAW REVIEW

A Journal of Comparative and Transnational Legal Scholarship



VOLUME I

Number One

Inaugural Issue

Featuring Six Original Articles

2026

Published by the

Foreign Trained Lawyers Association

New York, New York

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Published by the Foreign Trained Lawyers Association

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EDITORIAL BOARD

Volume I, Number One, 2026

Address all editorial correspondence to:

Foreign Trained Lawyers Association Law Review

New York, New York

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FOREWORD

Building the Inaugural Volume of the FTLA Law Review

It is with great pride that the Foreign Trained Lawyers Association presents Volume I, Number One of the FTLA Law Review. This inaugural volume marks the realization of a long held aspiration to establish a scholarly forum dedicated to the legal questions that confront foreign trained attorneys engaged with United States legal practice. The Review is conceived as a platform for sustained analytical engagement with the doctrinal, regulatory, and institutional questions that arise at the intersection of United States federal and state law and the legal traditions, training, and practice experience that foreign trained counsel bring to American practice.

The six Articles assembled in this volume address a range of topics in the broader fields of corporate governance, federal securities regulation, fiduciary oversight, contemporary contract law, and the supervision of capital markets and investment activity. The lead Article examines the regulatory architecture governing special purpose acquisition companies and de SPAC business combinations under United States federal securities law, including the substantial recent development of the framework through Securities and Exchange Commission rulemaking and Delaware judicial decisions. The five additional Articles examine related questions concerning shareholder activism and institutional investor engagement, executive compensation regulation and the fiduciary oversight of compensation arrangements, audit committee oversight and the integrity of financial reporting, the doctrinal foundations of contract formation and the enforceability of electronic agreements, and the doctrinal foundations and enforcement practice of insider trading regulation under United States federal securities law.

The Articles are unified by their attention to the cross border dimensions of the questions they examine, by their engagement with the comparative perspectives that foreign trained counsel are

particularly positioned to contribute, and by their commitment to the practical and institutional concerns that animate the work of foreign trained attorneys engaged with American practice. The Articles are also unified by their commitment to the development of advisory and institutional leadership capacity in their respective fields and by their identification of the contributions that foreign trained counsel can make to the strengthening of that capacity.

The Editorial Board of the Review extends its gratitude to the authors who contributed their scholarly work to this inaugural volume, to the broader community of foreign trained attorneys whose support made the establishment of the Review possible, and to the various institutions and individuals whose contributions to the field of foreign trained legal practice have made possible the engagement of foreign trained counsel with American legal practice and scholarship. The Review is offered with the aspiration that it will provide a sustained scholarly forum for the work of foreign trained attorneys and that it will contribute to the broader integration of foreign trained perspectives into the academic, professional, and policy communities of the American legal system.

The Review will publish at least one volume per year, with each volume comprising one or more issues containing original Articles and, in time, additional features including Notes, Comments, and Symposium contributions. The Editorial Board welcomes submissions of original scholarly work from foreign trained attorneys engaged with the questions that the Review addresses, and the Editorial Board looks forward to the development of the Review as a sustained forum for the work of the foreign trained legal community.

Kalenike Uridia

Editor in Chief

Foreign Trained Lawyers Association Law Review

New York, New York, 2026

ARTICLE I

Special Purpose Acquisition Companies, De SPAC Business Combinations, and the Evolving Disclosure and Liability Framework Under United States Federal Securities Law

By

Kalenike Uridia

ABSTRACT

This Article examines the regulatory architecture governing special purpose acquisition companies and de SPAC business combinations under United States federal securities law. The analysis traces the development of the SPAC structure from its origins in the late 1990s through the substantial market activity of 2020 and 2021, the subsequent decline in activity following enforcement and rulemaking developments, and the substantial regulatory engagement that culminated in the Securities and Exchange Commission rule adopted in January 2024. The Article examines the registration framework applicable to SPAC initial public offerings, the disclosure obligations applicable to de SPAC transactions, the application of the Private Securities Litigation Reform Act safe harbor for forward looking statements, the application of underwriter status to financial advisers in de SPAC transactions, the fiduciary obligations of SPAC sponsors and directors under Delaware law as developed in In re Multiplan Corp. Stockholders Litigation and subsequent decisions, and the comparative perspective on blank check company regulation across jurisdictions.

KEYWORDS: special purpose acquisition company, blank check company, projections, Private Securities Litigation Reform Act safe harbor, In re Multiplan, SPAC sponsor fiduciary obligations.

I. Introduction

The special purpose acquisition company, commonly known as the SPAC, is a publicly traded shell company organized for the purpose of acquiring or combining with one or more operating businesses through a transaction commonly referred to as a de SPAC business combination.[1] The SPAC structure has been used in the United States capital markets for several decades but achieved unprecedented prominence during the period from 2020 through early 2022, during which several hundred SPAC initial public offerings were completed each year and a substantial portion of the public offering activity in the United States was conducted through the SPAC structure.[2] The substantial market activity in this period was followed by a significant decline as enforcement actions, regulatory engagement, and changing market conditions reduced the attractiveness of the structure to sponsors, target companies, and investors.

The substantial regulatory engagement with the SPAC structure that has accompanied the rise and decline of SPAC activity is the subject of this Article.[3] The Securities and Exchange Commission has issued substantial guidance addressing the application of federal securities law to SPAC initial public offerings and de SPAC transactions, has brought enforcement actions addressing particular categories of conduct, and in January 2024 adopted final rules addressing the disclosure and liability framework applicable to SPAC and de SPAC transactions. The judicial decisions addressing the fiduciary obligations of SPAC sponsors and directors, principally under Delaware law, have substantially elaborated the application of corporate fiduciary doctrine to the distinctive features of SPAC operations.[4]

This Article surveys the regulatory architecture governing SPAC and de SPAC transactions under United States federal securities law, with particular attention to the doctrinal foundations, practical implementation, and ongoing development of the principal regulatory frameworks.[5] Part II addresses the structural features of SPAC transactions and the historical development of the structure. Part III examines the registration framework applicable to SPAC initial public offerings.

Part IV addresses the disclosure obligations applicable to de SPAC business combinations. Part V examines the application of the Private Securities Litigation Reform Act safe harbor for forward looking statements to projections used in de SPAC transactions, including the regulatory engagement with this question that culminated in the 2024 rule.[6] Part VI addresses the application of underwriter status to financial advisers in de SPAC transactions. Part VII examines the fiduciary obligations of SPAC sponsors and directors under Delaware law as developed in In re Multiplan Corp. Stockholders Litigation and subsequent decisions. Part VIII addresses the 2024 Securities and Exchange Commission SPAC rule. Part IX examines the comparative perspective on blank check company regulation across jurisdictions. Part X concludes with observations regarding the contributions of foreign trained counsel to contemporary SPAC practice.[7]

II. Structural Features of SPAC Transactions

The SPAC structure follows a substantially standardized pattern that has developed through several decades of market practice.[8] The structure begins with the formation of the SPAC by a sponsor, typically a private equity firm, hedge fund, family office, or experienced operating executive, who organizes the SPAC for the purpose of conducting an initial public offering and subsequently identifying and combining with an operating business. The sponsor typically receives founder shares representing twenty percent of the post initial public offering equity in exchange for a nominal contribution, with the founder shares often referred to as the promote because they represent the principal economic compensation of the sponsor for organizing and operating the SPAC.

The SPAC initial public offering generally raises capital through the sale of units, each unit consisting of one share of common stock and a fraction of a warrant to acquire additional common stock at a specified exercise price. The proceeds of the initial public offering are placed in a trust account that holds the funds pending either the completion of a business combination with an

operating business or the liquidation of the SPAC if no business combination is consummated within a specified period, typically twenty four months. The trust account structure provides investors with substantial protection of their capital, with the funds invested in low risk instruments and available for distribution to investors who exercise redemption rights in connection with a proposed business combination or upon the liquidation of the SPAC.[9]

The de SPAC business combination is the transaction through which the SPAC combines with an operating business, typically a private operating company that becomes the public successor entity to the SPAC. The de SPAC transaction may be structured as a merger, a stock acquisition, an asset acquisition, or various other structures depending on the particular circumstances of the transaction. The de SPAC transaction generally requires the approval of the SPAC stockholders, who exercise their redemption rights in connection with the vote on the transaction, with the consequence that the cash available to the combined entity following the transaction depends on the level of redemptions exercised by SPAC stockholders.[10]

The economic structure of SPAC transactions presents distinctive features that have been the subject of substantial regulatory and academic engagement. The sponsor founder shares represent a substantial dilution of the equity available to public stockholders following the de SPAC transaction, with the founder shares generally vesting upon the completion of the transaction and providing the sponsor with substantial economic interest in the completion of any transaction within the SPAC's life cycle. The warrants issued in the SPAC initial public offering provide additional dilution and additional economic interest in the completion of a transaction. The combination of these features creates substantial incentive structures that have been examined extensively in the academic literature and in the regulatory engagement with the SPAC structure.[11]

The historical development of the SPAC structure traces to the late 1990s and early 2000s, with substantial market activity throughout the 2000s and 2010s. The substantial growth of SPAC

activity from 2019 through early 2022 followed the involvement of prominent sponsors and target companies in SPAC transactions, the development of more sophisticated transaction structures, and the substantial increase in capital available for SPAC initial public offerings during the period of substantial monetary accommodation following the onset of the COVID 19 pandemic. The substantial decline in SPAC activity beginning in 2022 reflected enforcement actions by the Securities and Exchange Commission, the substantial regulatory engagement that ultimately culminated in the 2024 rule, the changing macroeconomic environment, and various other factors that reduced the attractiveness of the structure to sponsors and target companies.[12]

III. The Registration Framework for SPAC Initial Public Offerings

The SPAC initial public offering is conducted through a registration statement filed with the Securities and Exchange Commission under the Securities Act of 1933, generally on Form S 1 or Form F 1 depending on the jurisdiction of organization of the SPAC.[13] The registration statement provides substantial disclosure regarding the structure of the SPAC, the identity and background of the sponsor and the management team, the proposed acquisition strategy, the structure of the trust account, the redemption rights available to investors, the warrants issued as part of the units, the founder shares held by the sponsor, and various other matters relating to the structure and operation of the SPAC. The registration statement does not generally identify a particular target business, since the SPAC initial public offering is typically conducted before any specific target has been identified.

The registration statement for a SPAC initial public offering is subject to review by the Division of Corporation Finance of the Securities and Exchange Commission, with the staff conducting a substantive review of the disclosure and providing comments addressing matters identified in the review. The substantial regulatory engagement with SPAC initial public offering disclosure has produced a substantial body of staff comment practice and informal guidance

regarding the appropriate disclosure content. The Division of Corporation Finance has issued various forms of guidance regarding SPAC initial public offering disclosure, including the substantial guidance issued in connection with accounting questions regarding the classification of warrants and the substantial guidance regarding disclosure of sponsor compensation and conflicts of interest.[14]

The disclosure obligations applicable to SPAC initial public offerings address several distinctive features of the SPAC structure that have been subjects of substantial regulatory attention. The disclosure of the dilution that public investors will experience as a result of the founder shares and the warrants is a substantial disclosure subject, with the Securities and Exchange Commission emphasizing the importance of clear and prominent disclosure of dilution effects. The disclosure of the conflicts of interest that may arise between the sponsor and public stockholders, including conflicts arising from the sponsor's interest in completing any business combination within the SPAC's life cycle and the public stockholders' interest in completing only attractive transactions, is similarly a substantial disclosure subject. The disclosure of the redemption rights available to public stockholders and the operation of the trust account is also subject to substantial regulatory attention.[15]

IV. Disclosure Obligations in De SPAC Transactions

The de SPAC business combination is generally accompanied by substantial disclosure to SPAC stockholders, typically through a registration statement on Form S 4 or Form F 4 if securities are issued in the transaction, a proxy statement under Section 14A of the Securities Exchange Act of 1934 if stockholder approval is sought, or a tender offer document under Section 14E if the transaction is structured as a tender offer.[16] The disclosure provided in connection with a de SPAC transaction generally includes substantial information regarding the target business, the financial statements of the target business, the proposed structure of the combined entity, the

projections used in evaluating the transaction, the fairness of the transaction to SPAC stockholders, the conflicts of interest of the sponsor and directors, and various other matters relating to the transaction.

The disclosure of projections in connection with de SPAC transactions has been a subject of substantial regulatory and litigation attention. SPAC transactions have historically been distinguished from traditional initial public offerings by the use of projections in the disclosure to investors, with target businesses providing projections of future financial performance that have been used to support the valuation and to inform investor decisions regarding redemption and approval of the transaction.[17] The use of projections in the SPAC context has been the subject of substantial criticism, including concerns regarding the reliability of the projections, the use of optimistic assumptions, and the potential for projections to mislead investors regarding the prospects of the combined entity.

The disclosure of conflicts of interest in de SPAC transactions has similarly been a subject of substantial regulatory attention. The sponsor and the directors of the SPAC have substantial economic interests in the completion of any business combination within the SPAC's life cycle, including the founder shares that vest upon completion of the transaction, the warrants that have value if the transaction is completed and the combined entity performs adequately, and the potential opportunities for ongoing involvement with the combined entity. These economic interests create conflicts with the interests of public stockholders, who may benefit from the rejection of unattractive transactions and the redemption of their shares from the trust account. The Securities and Exchange Commission has emphasized the importance of clear and prominent disclosure of these conflicts in de SPAC transaction disclosure.[18]

The disclosure of the financial statements of the target business in de SPAC transactions has been the subject of substantial regulatory engagement. The target business in a de SPAC transaction is typically a private operating company that has not previously been subject to public

company financial reporting requirements, with the consequence that the financial statements of the target business may require substantial adjustment to comply with the requirements applicable to public company financial statements. The Public Company Accounting Oversight Board audit standards apply to the audit of the target business financial statements included in the de SPAC disclosure, and the substantial transition from private company to public company financial reporting has presented substantial challenges for many target businesses.[19]

V. The Forward Looking Statement Safe Harbor and Projections

The Private Securities Litigation Reform Act of 1995 established a safe harbor for forward looking statements, codified at Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934, that provides protection against private liability for forward looking statements that are accompanied by meaningful cautionary statements identifying important factors that could cause actual results to differ materially from those projected.[20] The safe harbor was designed to encourage the disclosure of forward looking information by reducing the litigation risk associated with such disclosure, with the expectation that the disclosure of forward looking information would provide investors with information helpful in evaluating securities. The application of the safe harbor to projections used in de SPAC transactions has been a subject of substantial regulatory and academic engagement.

The historical position regarding the application of the safe harbor to projections used in de SPAC transactions was that the safe harbor applied to such projections, with the consequence that projections accompanied by appropriate cautionary language were generally protected against private liability. This position was supported by the language of the safe harbor, which excludes from its protection statements made in connection with initial public offerings but does not specifically exclude statements made in connection with de SPAC transactions. The application of the safe harbor to de SPAC projections was a substantial component of the historical attractiveness

of the SPAC structure to target businesses, since it permitted the use of projections in marketing the transaction to investors in a manner not generally permitted in traditional initial public offerings.[21]

The Securities and Exchange Commission has substantially addressed the application of the safe harbor to de SPAC projections through guidance, enforcement, and rulemaking. The Commission has expressed concern regarding the use of optimistic projections in de SPAC transactions and the potential for such projections to mislead investors. The 2024 Securities and Exchange Commission SPAC rule addresses the application of the safe harbor to de SPAC projections through provisions that effectively eliminate the safe harbor protection for projections in de SPAC transactions, with the consequence that the use of projections in such transactions is now subject to the same liability framework that applies in traditional initial public offerings.[22] The substantial change in the liability framework applicable to de SPAC projections has had substantial implications for the use of projections in such transactions and for the broader attractiveness of the SPAC structure.

The judicial engagement with the application of the safe harbor to de SPAC projections has been substantial, with various courts addressing the application of the safe harbor to particular fact patterns. The decisions have addressed the adequacy of the cautionary language accompanying particular projections, the application of the safe harbor to projections that are alleged to have been known to be false at the time of the disclosure, and various other matters relating to the application of the safe harbor. The substantial judicial engagement with these questions, in combination with the regulatory engagement, has produced a substantial body of doctrine and practice regarding the use of projections in de SPAC transactions.[23]

VI. Underwriter Status of Financial Advisers in De SPAC Transactions

The application of underwriter status to financial advisers in de SPAC transactions has been a subject of substantial regulatory engagement.[24] The Securities Act of 1933 defines an underwriter broadly to include any person who has purchased from an issuer with a view to, or offers or sells for an issuer in connection with, the distribution of any security, with the underwriter status carrying substantial liability under Section 11 of the Securities Act for material misstatements or omissions in registration statements. The application of underwriter status to financial advisers in de SPAC transactions raises distinctive questions because the financial advisers may be involved in various capacities including as advisers to the SPAC, as advisers to the target business, and as marketers of the de SPAC transaction to investors.

The Securities and Exchange Commission addressed the application of underwriter status to financial advisers in de SPAC transactions through the 2022 proposed rule and the 2024 final rule. The 2022 proposed rule included a provision that would have explicitly designated certain participants in de SPAC transactions as statutory underwriters, with the consequence that such participants would have been subject to the substantial liability framework applicable to underwriters under Section 11 of the Securities Act. The proposed provision generated substantial industry engagement, with substantial concern regarding the breadth of the proposed designation and the potential implications for the participation of financial advisers in de SPAC transactions.[25]

The 2024 final rule did not adopt the explicit underwriter designation included in the 2022 proposed rule but addressed the underwriter status question through alternative provisions and accompanying guidance. The 2024 rule provides that financial advisers and other participants in de SPAC transactions may be considered statutory underwriters depending on the circumstances of their involvement, with the application of underwriter status determined on the basis of the substantive nature of the participant's role rather than through an explicit categorical designation.

The substantial change in the regulatory approach to underwriter status, in combination with the broader changes introduced by the 2024 rule, has substantially shaped the participation of financial advisers in de SPAC transactions and the broader market for such transactions.[26]

VII. Fiduciary Obligations of SPAC Sponsors and Directors

The fiduciary obligations of SPAC sponsors and directors under Delaware law have been substantially elaborated through judicial decisions over the past several years, with the principal development occurring in In re Multiplan Corp. Stockholders Litigation in 2022 and the subsequent line of cases.[27] The Multiplan decision, issued by the Delaware Court of Chancery in January 2022, addressed the fiduciary obligations of SPAC sponsors and directors in connection with de SPAC transactions and held that the entire fairness standard of review applies to such transactions because of the substantial conflicts of interest between the sponsor and public stockholders.[28] The decision substantially altered the analytical framework applicable to de SPAC transactions and has had substantial implications for the conduct of such transactions.

The Multiplan decision identified several categories of conflicts of interest that warrant the application of the entire fairness standard. The first category is the conflict between the sponsor's interest in completing any business combination within the SPAC's life cycle, motivated by the founder shares and warrants that vest upon completion of a transaction, and the public stockholders' interest in completing only transactions that are attractive on a stand alone basis. The second category is the conflict between the directors' interests in continuing engagement with the combined entity following the transaction and the public stockholders' interest in the completion of only attractive transactions. The third category is the conflict between the disclosure of accurate and complete information to public stockholders and the various interests of the sponsor and the directors in completing the transaction.[29]

The application of the entire fairness standard to de SPAC transactions imposes substantial procedural and substantive obligations on SPAC sponsors and directors. The procedural obligations require that the de SPAC transaction be approved by independent directors after substantial due diligence and consideration, with the directors providing substantive engagement with the merits of the transaction and the alternatives available to the SPAC. The substantive obligations require that the de SPAC transaction be substantively fair to public stockholders, considering the price paid by the SPAC for the target business, the structure of the transaction, the financial projections used to support the valuation, and various other matters. The combination of these procedural and substantive obligations creates substantial responsibilities for SPAC sponsors and directors and has substantially shaped the conduct of de SPAC transactions following the Multiplan decision.[30]

The line of cases following Multiplan has continued to elaborate the application of fiduciary doctrine to SPAC transactions. The decisions have addressed the application of the entire fairness standard to particular fact patterns, the procedures available to SPAC sponsors and directors to address the application of the standard, the disclosure obligations applicable to de SPAC transactions under Delaware law, and various other matters relating to the application of fiduciary doctrine. The substantial development of doctrine in this area continues, with judicial decisions, academic analysis, and practitioner engagement contributing to the ongoing elaboration of the framework.[31]

VIII. The 2024 Securities and Exchange Commission SPAC Rule

The Securities and Exchange Commission adopted final rules addressing SPAC and de SPAC transactions in January 2024, with the rules representing the culmination of substantial regulatory engagement with the SPAC structure over the preceding several years.[32] The 2024 rule addresses several distinct categories of regulatory concerns regarding SPAC and de SPAC

transactions, including the disclosure obligations applicable to such transactions, the application of the forward looking statement safe harbor to projections used in de SPAC transactions, the underwriter status of financial advisers in de SPAC transactions, the timing requirements applicable to such transactions, and various other matters. The rule represents a substantial expansion of the regulatory framework applicable to SPAC and de SPAC transactions and has had substantial implications for the conduct of such transactions.

The disclosure provisions of the 2024 rule require enhanced disclosure regarding several substantial subjects, including the dilution that public investors will experience as a result of the founder shares and the warrants, the conflicts of interest between the sponsor and public stockholders, the determination by the SPAC board of directors regarding the fairness of the de SPAC transaction to public stockholders, and various other matters. The rule also requires that the de SPAC transaction disclosure be tailored to address the particular circumstances of the transaction, with substantial emphasis on the disclosure of the substantive considerations that informed the SPAC's decision to enter into the transaction and the analyses supporting the determination that the transaction is fair to public stockholders.[33]

The provisions of the 2024 rule addressing the forward looking statement safe harbor effectively eliminate the safe harbor protection for projections used in de SPAC transactions. The rule provides that the safe harbor does not apply to forward looking statements made in connection with de SPAC transactions, with the consequence that such statements are subject to the same liability framework that applies in traditional initial public offerings. The substantial change in the liability framework applicable to de SPAC projections has had substantial implications for the use of projections in such transactions and has reduced the historical advantage of the SPAC structure relative to traditional initial public offerings.[34]

The provisions of the 2024 rule addressing the underwriter status of financial advisers in de SPAC transactions, while not adopting the explicit categorical designation included in the 2022

proposed rule, address the question through alternative provisions and accompanying guidance. The rule and accompanying guidance emphasize that financial advisers and other participants in de SPAC transactions may be considered statutory underwriters depending on the substantive nature of their involvement in the transaction, with the consequence that such participants may be subject to the substantial liability framework applicable to underwriters under Section 11 of the Securities Act. The substantial regulatory engagement with this question has shaped the participation of financial advisers in de SPAC transactions and the broader market for such transactions.[35]

The implementation of the 2024 rule has substantially altered the regulatory landscape applicable to SPAC and de SPAC transactions. The substantial expansion of the disclosure obligations, the elimination of the forward looking statement safe harbor for de SPAC projections, the substantial regulatory engagement with the underwriter status question, and the various other provisions of the rule have collectively reduced the historical attractiveness of the SPAC structure relative to traditional initial public offerings. The market for SPAC initial public offerings and de SPAC transactions has continued to develop following the adoption of the rule, with the level of activity substantially below the historical peak of 2020 and 2021 but with continuing engagement by sponsors, target businesses, and investors with the structure.[36]

IX. Comparative Perspective on Blank Check Company Regulation

The comparative perspective on blank check company regulation across jurisdictions reveals substantial variation in approach.[37] The European Union and the United Kingdom have developed regulatory frameworks for special purpose acquisition companies that address several of the same concerns addressed by the United States regulatory framework, with various distinctive features reflecting the regulatory traditions and market structures of those jurisdictions. The London Stock Exchange and the Financial Conduct Authority adopted substantial reforms in

2021 to facilitate the listing of SPACs on the London market, with the reforms addressing the previous restrictions that had limited the use of the SPAC structure in the United Kingdom market. The substantial development of SPAC activity in European markets, while substantially below the level of activity in the United States, has been a substantial component of the broader development of European capital markets.

The Hong Kong Stock Exchange adopted listing rules for SPACs in 2022, providing a framework for the listing of SPACs on the Hong Kong market. The Hong Kong rules differ substantially from the United States framework in various respects, including the requirements for sponsor qualifications, the size of the SPAC, the timing requirements for completion of a de SPAC transaction, and various other matters. The Singapore Exchange similarly adopted listing rules for SPACs in 2021, providing a framework for the listing of SPACs on the Singapore market with various distinctive features reflecting the regulatory tradition and market structure of Singapore. The substantial development of SPAC frameworks in Asian markets has reflected both the influence of the United States SPAC market and the distinctive considerations applicable to Asian capital markets.[38]

The integration of cross border considerations into SPAC and de SPAC practice presents substantial challenges. SPACs may be organized in jurisdictions different from the jurisdictions of the target businesses they ultimately combine with, may be listed on exchanges in jurisdictions different from the jurisdictions of organization or operation of the SPAC or the target business, and may engage in various other cross border arrangements. The cross jurisdictional nature of many SPAC transactions creates substantial complexity for the participants and requires sustained engagement with the regulatory frameworks of multiple jurisdictions. The development of advisory capacity adequate to these cross border considerations is an ongoing priority for the field, and the contributions of foreign trained counsel to the development of this capacity are substantial.[39]

X. Conclusion and Implications for Foreign Trained Counsel

The regulatory architecture governing SPAC and de SPAC transactions under United States federal securities law has developed substantially over the past several years through the substantial regulatory engagement of the Securities and Exchange Commission, the substantial judicial development of fiduciary doctrine applicable to SPAC sponsors and directors, and the substantial market engagement of sponsors, target businesses, investors, and advisers with the SPAC structure.[40] The resulting framework addresses the registration of SPAC initial public offerings, the disclosure obligations applicable to de SPAC business combinations, the application of the forward looking statement safe harbor to projections used in de SPAC transactions, the underwriter status of financial advisers in de SPAC transactions, the fiduciary obligations of SPAC sponsors and directors under Delaware law, and the comparative dimensions of blank check company regulation across jurisdictions.

The contributions that foreign trained counsel can make to the practice of SPAC and de SPAC law are substantial. The cross border dimensions of contemporary SPAC practice, including the structuring of cross border transactions, the integration of regulatory frameworks across jurisdictions, the conduct of due diligence on foreign target businesses, the management of disclosure obligations applicable to cross border transactions, and the practical implementation of compliance programs adequate to cross border circumstances, are areas in which the cross jurisdictional expertise of foreign trained counsel is particularly valuable.[41] The integration of foreign trained counsel into the legal departments of major SPAC sponsors, into the law firms that advise on SPAC transactions, into the financial institutions that participate in such transactions, and into the academic and policy communities that engage with SPAC regulation is an important component of the broader development of advisory capacity adequate to contemporary practice.

The Foreign Trained Lawyers Association Law Review aspires to provide a forum for the analytical engagement of foreign trained counsel with the substantive and practical questions that

contemporary SPAC and de SPAC practice raises. The development of scholarly engagement with these questions, the integration of comparative perspectives into the analysis of SPAC practice, and the contribution of foreign trained perspectives to the policy debates concerning the development of regulatory frameworks are all components of the broader project that the Law Review seeks to advance. The continued development of advisory and institutional leadership capacity adequate to the cross border dimensions of contemporary SPAC practice is an ongoing priority, and the contributions of foreign trained counsel to that development are a substantial component of the broader work that the field requires.[42]

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ARTICLE II

Shareholder Activism, Stewardship, and the Engagement of Institutional Investors with United States Operating Corporations: Doctrinal Foundations, Regulatory Architecture, and the Evolving Role of Foreign Trained Counsel

By

Elene Landia

ABSTRACT

This Article examines the doctrinal foundations and regulatory architecture governing shareholder activism and the engagement of institutional investors with United States operating corporations. The analysis traces the evolution of shareholder engagement from a peripheral feature of corporate governance into a central mechanism through which institutional investors influence corporate strategy, capital allocation, governance arrangements, and operational practice. The Article examines the principal regulatory frameworks that structure shareholder engagement, including the proxy solicitation rules under Section 14 of the Securities Exchange Act of 1934, the beneficial ownership reporting obligations under Section 13, the regulation of proxy advisory firms, the doctrines of state corporate law that govern director fiduciary obligations in the context of activist engagement, and the developing body of stewardship norms promulgated by collective investor organizations. The Article concludes with observations regarding the contributions that foreign trained counsel can make to the analytical and operational demands of contemporary shareholder engagement.

KEYWORDS: shareholder activism, institutional investor stewardship, proxy solicitation, Schedule 13D, Schedule 13G, proxy advisory firms, corporate governance, fiduciary duty, shareholder engagement, foreign trained counsel

I. Introduction

The engagement of institutional investors with United States operating corporations has undergone a substantial transformation over the past several decades.[1] What was once a peripheral feature of corporate governance, in which institutional investors typically deferred to management on matters of corporate strategy and rarely engaged actively with the corporations in their portfolios, has become a central mechanism through which institutional investors exercise influence over corporate strategy, capital allocation, governance arrangements, executive compensation, and operational practice.[2] This transformation has been driven by several interrelated developments, including the substantial concentration of equity ownership in the hands of institutional investors, the development of activist investment strategies pursued by hedge funds and other specialized investors, the emergence of stewardship norms that articulate the engagement responsibilities of institutional investors, and the regulatory developments that have shaped the contours of permissible engagement.[3]

The transformation has substantial implications for the operation of United States capital markets and the accountability of United States operating corporations. Shareholder engagement has become a significant determinant of corporate strategic decisions, with activist campaigns frequently producing changes in board composition, executive leadership, capital allocation, business portfolio, and corporate structure.[4] The voting policies and engagement practices of major institutional investors influence governance practice across the broader corporate community, with the announced positions of large asset managers shaping corporate behavior even in the absence of direct engagement. The regulatory frameworks that govern engagement, including the proxy solicitation rules, the beneficial ownership reporting obligations, and the regulation of proxy advisory firms, structure the contours within which engagement occurs and shape the strategic options available to engaged investors.[5]

This Article examines the doctrinal foundations and regulatory architecture of shareholder engagement with United States operating corporations, with particular attention to the analytical and operational challenges that confront institutional investors and the corporations with which they engage. Part II surveys the principal forms of shareholder engagement, distinguishing among activist campaigns, stewardship engagement by long term institutional investors, collective engagement through investor organizations, and other modalities of investor influence. Part III examines the regulatory architecture that structures engagement, including the proxy solicitation rules, the beneficial ownership reporting obligations, and the regulation of proxy advisory firms.[6] Part IV addresses the doctrines of state corporate law that govern director fiduciary obligations in the context of activist engagement, including the application of business judgment, enhanced scrutiny, and entire fairness standards to director responses to engagement. Part V examines the developing body of stewardship norms and the institutional infrastructure of collective engagement. Part VI concludes with observations regarding the contributions that foreign trained counsel can make to the analytical and operational demands of contemporary shareholder engagement.[7]

II. Forms of Shareholder Engagement

Contemporary shareholder engagement with United States operating corporations takes several distinguishable forms that, while sharing the common feature of investor influence on corporate decision making, differ substantially in their objectives, methods, and operational characteristics.[8] The first form, commonly described as activist investment, involves the acquisition of substantial equity positions in target corporations by investors pursuing specific strategic, governance, or operational changes, frequently accompanied by public campaigns designed to influence other shareholders, the board of directors, and corporate management. Activist investors typically include hedge funds and other specialized investment vehicles whose investment strategies are oriented toward the realization of value through corporate change.[9]

Activist campaigns frequently involve the nomination of director candidates, the submission of shareholder proposals under Rule 14a sub paragraph 8, the conduct of proxy solicitations in opposition to management proposals, and various other formal mechanisms through which investor preferences can be advanced.[10]

The second form, commonly described as stewardship engagement, involves the ongoing engagement of long term institutional investors with the corporations in their portfolios on matters of governance, strategy, and operational practice. Stewardship engagement typically does not involve the acquisition of new equity positions for the purpose of engagement and does not typically involve public campaigns. Rather, stewardship engagement is conducted through ongoing dialogue between institutional investors and corporate management and boards, through the voting of proxies in accordance with stewardship principles, and through participation in collective investor initiatives.[11] The major asset managers, including BlackRock, Vanguard, and State Street, have developed substantial stewardship operations that engage with portfolio companies on a wide range of matters and articulate stewardship principles that guide their engagement and voting activity.

The third form, commonly described as collective engagement, involves the coordination of multiple institutional investors in engagement with corporations on common matters of concern. Collective engagement may be conducted through formal investor organizations, including the Council of Institutional Investors and the International Corporate Governance Network, through informal investor coalitions formed to address specific issues, or through engagement initiatives sponsored by particular investor organizations. The regulatory considerations applicable to collective engagement include the rules under Section 13 paragraph d of the Securities Exchange Act regarding the formation of beneficial ownership groups, the rules under Section 14 of the Exchange Act regarding proxy solicitation, and various other regulatory provisions that may apply to coordinated investor activity.[12]

The fourth form, commonly described as shareholder proposal activity, involves the submission of shareholder proposals under Rule 14a sub paragraph 8 of the Exchange Act for inclusion in corporate proxy statements and consideration at annual shareholder meetings. Shareholder proposals are subject to specific procedural and substantive requirements set forth in the rule, including ownership requirements applicable to proponents, procedural requirements relating to the form and timing of submissions, and substantive grounds on which proposals may be excluded from proxy statements. The Securities and Exchange Commission staff issues guidance and no action letters regarding the application of these requirements to particular proposals, and the resulting body of guidance shapes the practical scope of shareholder proposal activity.[13]

The fifth form, which has gained substantial significance in recent years, involves engagement on matters of environmental, social, and governance significance, including climate related matters, human capital management, diversity and inclusion, and various other matters that have come to occupy a significant place in corporate governance practice.[14] Engagement on these matters may be conducted through any of the modalities identified above, including through activist campaigns specifically focused on environmental and social matters, through stewardship engagement that incorporates environmental and social considerations, through collective initiatives that address particular environmental and social issues, and through shareholder proposal activity that advances environmental and social objectives. The growth of engagement on environmental, social, and governance matters has substantially influenced the development of stewardship norms, the design of investor organizations, and the practical conduct of engagement.[15]

III. Regulatory Architecture of Shareholder Engagement

The regulatory architecture that structures shareholder engagement with United States operating corporations consists of several principal components, each of which addresses a particular dimension of engagement activity and each of which has been substantially elaborated through regulatory rulemaking, judicial interpretation, and administrative practice.[16] The proxy solicitation rules under Section 14 of the Securities Exchange Act of 1934, the beneficial ownership reporting obligations under Section 13, the regulation of proxy advisory firms, and various other regulatory provisions collectively define the contours within which engagement occurs and shape the strategic options available to engaged investors.[17]

The proxy solicitation rules under Section 14 paragraph a of the Exchange Act, set forth in Regulation 14A and the related rules, govern the conduct of proxy solicitations by issuers, dissident shareholders, and other persons engaged in soliciting proxies in connection with shareholder votes.[18] The rules address the substantive content of proxy statements, the procedural requirements applicable to the conduct of solicitations, the disclosure obligations applicable to participants in solicitations, and various other matters relating to the conduct of proxy contests. The rules apply, with various exceptions, to all communications that may reasonably be calculated to result in the procurement, withholding, or revocation of a proxy, with the consequence that a wide range of communications between investors and other parties may be subject to the rules. The exceptions to the proxy solicitation rules, including those for communications among shareholders that do not seek to procure proxies and for various other categories of communications, are important to the practical scope of engagement activity.[19]

The beneficial ownership reporting obligations under Section 13 paragraph d and Section 13 paragraph g of the Exchange Act require the filing of beneficial ownership reports by persons who acquire beneficial ownership of more than five percent of any class of equity securities registered under Section 12 of the Exchange Act.[20] Schedule 13D, applicable to persons who do not qualify

for the alternative reporting framework of Schedule 13G, requires substantial disclosure regarding the acquisition, including the identity of the beneficial owner, the source and amount of funds used in the acquisition, the purpose of the acquisition, and the contracts, arrangements, understandings, or relationships with respect to the securities. Schedule 13G, available to certain categories of beneficial owners including passive investors and qualified institutional investors that meet specified requirements, requires more limited disclosure. The distinction between Schedule 13D and Schedule 13G reporting has substantial implications for activist investors, who may be required to file Schedule 13D upon the formulation of an activist intent and who must comply with the more substantial disclosure obligations of that form.[21]

The Securities and Exchange Commission has, in recent years, undertaken substantial regulatory engagement with the beneficial ownership reporting framework. In 2023, the Commission adopted amendments to the Schedule 13D and Schedule 13G filing requirements that shortened the deadline for initial Schedule 13D filings, accelerated the deadline for filing amendments to Schedule 13D, modified the deadlines for Schedule 13G filings, and addressed various other matters relating to the beneficial ownership reporting framework.[22] These amendments have substantial implications for the timing of activist accumulations and the disclosure obligations applicable to engaged investors, and they reflect ongoing regulatory engagement with the appropriate balance between investor disclosure and the operational realities of investment activity.

The regulation of proxy advisory firms has emerged as a significant component of the regulatory architecture of shareholder engagement. Proxy advisory firms, including Institutional Shareholder Services and Glass Lewis, provide voting recommendations to institutional investors with respect to proxy proposals submitted to shareholder votes, and the substantial influence of these recommendations on institutional investor voting has generated regulatory attention.[23] The Securities and Exchange Commission, in 2020 amendments to Rule 14a sub paragraph 2 paragraph

b of the Exchange Act, addressed the application of the proxy rules to proxy voting advice, and the implementation of these amendments has continued to develop. The regulatory engagement with proxy advisory firms reflects ongoing concerns regarding the accuracy of proxy advisory recommendations, the management of conflicts of interest at proxy advisory firms, and the appropriate scope of regulation of proxy advisory activity.[24]

Various other regulatory provisions affect the conduct of shareholder engagement, including the antifraud provisions of Section 10 paragraph b of the Exchange Act and Rule 10b 5, the prohibitions on insider trading and tipping under those provisions, the obligations relating to material nonpublic information that may be exchanged in the course of engagement, the obligations of institutional investors under the Investment Advisers Act of 1940 and the Investment Company Act of 1940, and various other regulatory provisions that may apply to particular engagement activities.[25] The integration of these various regulatory provisions into the practical conduct of engagement is a substantial undertaking that requires sustained engagement by legal counsel and by the institutional investors and corporations engaged in the activity.

IV. Director Fiduciary Obligations and the Response to Engagement

The doctrines of state corporate law, principally the law of Delaware, that govern director fiduciary obligations in the context of activist engagement structure the analysis of director conduct in litigation arising from activist campaigns and from the responses of corporate boards to such campaigns.[26] The fiduciary duties of corporate directors, including the duty of care, the duty of loyalty, and the duty of good faith that the Delaware Supreme Court has recognized as a component of the duty of loyalty, apply to director conduct in connection with activist engagement, and the standards of judicial review applicable to director conduct vary depending on the circumstances of the engagement and the nature of the director response.

The business judgment rule, the default standard of judicial review applicable to director conduct, presumes that directors acting in connection with corporate decisions have acted on an informed basis, in good faith, and in the honest belief that the action taken was in the best interests of the corporation. The presumption may be rebutted by a showing that directors acted in breach of any of the elements of the rule, but in the absence of such a showing the presumption is dispositive of judicial review.[27] The application of the business judgment rule to director conduct in the context of activist engagement requires the analysis of whether the directors satisfied the elements of the rule in their consideration of the activist proposals, their engagement with the activist investors, and their decisions regarding the appropriate corporate response.

The enhanced scrutiny standard, articulated by the Delaware Supreme Court in Unocal Corp. v. Mesa Petroleum Co. and elaborated in subsequent decisions, applies to director conduct in connection with takeover defenses and certain other categories of corporate action.[28] The standard requires that directors demonstrate reasonable grounds for believing that a danger to corporate policy and effectiveness existed and that the response adopted was reasonable in relation to the threat posed. The application of enhanced scrutiny to director conduct in the context of activist engagement depends on the specific circumstances and the nature of the director response, with structural defenses such as poison pills generally subject to enhanced scrutiny review.[29]

The Revlon doctrine, articulated by the Delaware Supreme Court in Revlon, Inc. v. MacAndrews and Forbes Holdings, Inc., requires that directors who have determined to sell the corporation must seek the highest value reasonably available for the shareholders.[30] The doctrine applies to specific categories of transactions in which the corporation will undergo a change of control, and its application to director conduct in the context of activist engagement depends on whether the engagement results in or is likely to result in a transaction that triggers the application of the doctrine. The doctrine has been substantially elaborated through subsequent decisions including Paramount Communications, Inc. v. Time Inc. and Paramount Communications, Inc. v.

QVC Network, Inc., and the body of case law establishes the contours within which directors may operate in transactions subject to Revlon.[31]

The entire fairness standard, applicable to transactions involving conflicts of interest including transactions in which controlling shareholders are on both sides of the transaction, requires that directors demonstrate that the transaction was the product of fair dealing and at a fair price. The application of entire fairness review to director conduct in the context of activist engagement is generally limited to circumstances involving conflicts of interest among the directors or the corporation, but the standard may apply in particular circumstances involving director conduct that gives rise to conflict concerns.[32]

The poison pill, formally known as a shareholder rights plan, is a structural defensive measure that has been substantially elaborated through Delaware case law and that is frequently relevant to corporate responses to activist engagement.[33] The Delaware courts have upheld the use of poison pills under the enhanced scrutiny standard in various circumstances, while subjecting their use to ongoing review of the proportionality of the response to the threat presented. The Delaware Court of Chancery, in decisions including Versata Enterprises, Inc. v. Selectica, Inc. and Williams Companies Stockholder Litigation, has elaborated on the application of poison pill doctrine to particular fact patterns and has identified circumstances in which the use of pills may be inconsistent with director fiduciary obligations.[34] The selection and implementation of poison pills, the conduct of negotiations with activist investors regarding the redemption or modification of pills, and the broader engagement of pill mechanics with activist campaigns are substantial components of contemporary corporate governance practice.

The advance notice bylaws, which require shareholders proposing director nominations or other proposals to provide advance notice to the corporation, have also been substantially elaborated through Delaware case law and are relevant to corporate engagement with activist investors.[35] The Delaware courts have generally upheld the validity of advance notice bylaws

while requiring that they be applied in a manner consistent with director fiduciary obligations and that they not be used to disenfranchise shareholders. The recent Delaware Court of Chancery decision in Kellner v. AIM ImmunoTech Inc. addressed the application of advance notice bylaws to a particular activist nomination and provided substantial guidance regarding the appropriate scope of such bylaws.[36] The drafting and application of advance notice bylaws is a substantial component of corporate governance practice for issuers facing or anticipating activist engagement.

V. Stewardship Norms and Collective Engagement

The development of stewardship norms and the institutional infrastructure of collective engagement have substantially shaped the contemporary practice of shareholder engagement. Stewardship norms, articulated through codes promulgated by collective investor organizations and through the stewardship principles of major asset managers, identify the engagement responsibilities of institutional investors and structure the conduct of engagement activity.[37] The institutional infrastructure of collective engagement, including the various investor organizations through which institutional investors collaborate on engagement matters, provides the practical platforms through which collective engagement is conducted.

The Stewardship Code of the United Kingdom, originally promulgated by the Financial Reporting Council in 2010 and substantially revised in subsequent years, established the foundational template for the elaboration of stewardship norms.[38] The Code identifies a series of principles addressing the engagement responsibilities of institutional investors, including the integration of stewardship into investment activity, the development of clear stewardship policies, the conduct of engagement on substantive matters, the exercise of voting rights in accordance with stewardship policies, and the reporting of stewardship activity to clients and beneficiaries. The United Kingdom Code has substantially influenced the development of stewardship norms in other

jurisdictions, with similar codes promulgated in various European jurisdictions, in Japan, in Australia, and in other markets.

In the United States, the development of formal stewardship codes has been more limited than in the United Kingdom and other jurisdictions, but the elaboration of stewardship principles has proceeded through other mechanisms. The Investor Stewardship Group, a collective of major institutional investors, has promulgated stewardship principles addressing the engagement responsibilities of its members. The major asset managers including BlackRock, Vanguard, and State Street have promulgated stewardship principles that articulate their engagement responsibilities and guide their voting and engagement activity. The Council of Institutional Investors has promulgated corporate governance policies that address the expectations of its members regarding governance practice at portfolio companies, and these policies provide a substantial part of the institutional framework within which engagement occurs.[39]

The collective engagement of institutional investors through investor organizations and informal coalitions has emerged as a significant feature of contemporary engagement practice. The Council of Institutional Investors and the International Corporate Governance Network provide formal organizational platforms for collective engagement on governance matters of common concern to their members. The Climate Action 100 Plus initiative, focused on engagement with major emitters on climate related matters, illustrates the development of issue specific collective engagement initiatives that have gained substantial significance in recent years. Various other formal and informal investor coalitions provide additional platforms for collective engagement on particular matters.[40]

The legal and regulatory considerations applicable to collective engagement are substantial and require careful attention by participating investors. The rules under Section 13 paragraph d of the Exchange Act regarding the formation of beneficial ownership groups, the proxy solicitation rules under Section 14 of the Exchange Act, the antitrust considerations that may arise from

coordinated investor activity, and various other regulatory considerations affect the structure and conduct of collective engagement.[41] The development of legal frameworks adequate to the operation of collective engagement, while preserving the legitimate concerns regarding coordinated investor activity that the regulatory framework reflects, is an ongoing area of regulatory development and professional engagement.

The development of stewardship norms and collective engagement infrastructure has substantial implications for the practical conduct of shareholder engagement. The articulation of stewardship principles by major asset managers shapes the engagement and voting practices of those managers, with substantial influence on the broader practice of engagement.[42] The collective engagement initiatives provide platforms through which institutional investors can advance positions that individual investors might not advance independently, and the resulting collective positions can substantially influence corporate practice. The integration of stewardship considerations into investment activity, including through the development of stewardship policies, the integration of stewardship considerations into portfolio management, and the reporting of stewardship activity to clients and beneficiaries, is an ongoing area of professional development.

VI. Implications for Foreign Trained Counsel

The contemporary practice of shareholder engagement with United States operating corporations generates substantial professional opportunities and analytical demands that foreign trained counsel are well positioned to address.[43] The cross border dimensions of contemporary engagement, including the engagement of foreign institutional investors with United States issuers, the engagement of United States institutional investors with the cross border operations of United States issuers, and the integration of engagement practice across jurisdictions with different regulatory frameworks, are substantial components of contemporary engagement practice. The

cross jurisdictional expertise, comparative analytical perspective, and substantive knowledge of foreign legal and regulatory frameworks that characterize many foreign trained practitioners are particularly valuable in this professional environment.

Several specific areas warrant particular attention from foreign trained counsel. The engagement of foreign institutional investors with United States issuers, including the application of United States proxy solicitation rules and beneficial ownership reporting obligations to foreign engaged investors, raises questions that benefit from the comparative perspective that foreign trained counsel can contribute. The engagement of United States institutional investors with the cross border operations of United States issuers, including the application of foreign legal and regulatory frameworks to the cross border activities that engagement may address, similarly benefits from the cross jurisdictional expertise of foreign trained practitioners.[44] The integration of stewardship norms across jurisdictions, including the application of foreign stewardship codes to the engagement activity of investors with substantial cross border activity and the comparative analysis of stewardship frameworks, is an area of ongoing professional development.

The role of foreign trained counsel in the legal departments of institutional investors, in the law firms that advise institutional investors and corporations on engagement matters, and in the various advisory and academic institutions that engage with shareholder engagement and corporate governance is an important component of the development of advisory capacity adequate to contemporary practice.[45] The integration of foreign trained counsel into these various professional roles, the support of professional development opportunities that prepare foreign trained counsel for engagement practice, and the engagement of foreign trained counsel with the policy debates that shape the development of engagement practice are all components of the broader development of professional capacity in this area.

The Foreign Trained Lawyers Association Law Review aspires to provide a forum for the analytical engagement of foreign trained counsel with the substantive and practical questions that

contemporary shareholder engagement raises. The development of scholarly engagement with these questions, the integration of comparative perspectives into the analysis of engagement practice, and the contribution of foreign trained perspectives to the policy debates concerning the development of engagement frameworks are all components of the broader project that the Law Review seeks to advance.[46]

The transformation of shareholder engagement from a peripheral feature of corporate governance into a central mechanism of investor influence on corporate practice has generated substantial questions about the appropriate scope and conduct of engagement, the regulatory frameworks that should structure engagement, and the institutional arrangements through which engagement is conducted. These questions will continue to occupy regulators, scholars, and practitioners in the coming years, and the contributions of foreign trained counsel to the analytical and practical engagement with these questions can substantially strengthen the capacity of the broader professional community to address them. The work continues, and the engagement of foreign trained counsel in that work is a substantial contribution to the integrity and effectiveness of the broader system of corporate governance and investor engagement.[47]

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ARTICLE III

Executive Compensation Regulation, Pay Versus Performance Disclosure, and the Fiduciary Oversight of Compensation Arrangements at United States Public Companies

By

Mariami Zhorzholiani

ABSTRACT

This Article examines the regulatory architecture governing executive compensation at United States public companies, with particular attention to the substantial reforms introduced by the Dodd Frank Wall Street Reform and Consumer Protection Act of 2010 and the Securities and Exchange Commission rulemaking implementing those reforms. The analysis examines the say on pay obligations imposed by Section 951, the compensation committee independence requirements imposed by Section 952, the pay ratio disclosure obligations imposed by Section 953, the clawback obligations imposed by Section 954, the hedging policy disclosure obligations imposed by Section 955, and the pay versus performance disclosure obligations imposed by Section 953 paragraph a as ultimately implemented by the Commission in 2022. The Article also examines Section 162 paragraph m of the Internal Revenue Code, the disclosure obligations imposed by Item 402 of Regulation S K, the fiduciary obligations of compensation committees under state corporate law, and the comparative perspective on executive compensation regulation across jurisdictions.

KEYWORDS: executive compensation, Dodd Frank Act Section 951, say on pay, compensation committee independence, pay ratio disclosure, clawback, pay versus performance, Item 402 Regulation S K, Section 162(m), comparative compensation regulation

I. Introduction

The regulation of executive compensation at United States public companies has undergone substantial development over the past two decades, with the Dodd Frank Wall Street Reform and Consumer Protection Act of 2010 introducing several reforms that have transformed the disclosure, governance, and substantive regulation of compensation arrangements.[1] The reforms address several distinct dimensions of executive compensation practice, including shareholder voting on compensation, the independence of compensation committees and their advisers, the disclosure of compensation arrangements, the relationship between compensation and corporate performance, and the recovery of compensation in circumstances involving accounting misstatements. The implementation of these reforms through Securities and Exchange Commission rulemaking has continued over more than a decade following the enactment of the Dodd Frank Act, and the resulting regulatory architecture is among the most substantially developed components of contemporary federal securities regulation.[2]

This Article surveys the regulatory architecture governing executive compensation at United States public companies, with particular attention to the doctrinal foundations, practical implementation, and ongoing development of the principal regulatory frameworks.[3] Part II examines the say on pay obligations imposed by Section 951 of the Dodd Frank Act and the implementing regulations. Part III addresses the compensation committee independence requirements imposed by Section 952 and the listing standards adopted by the national securities exchanges to implement those requirements. Part IV examines the pay ratio disclosure obligations imposed by Section 953 paragraph b and the implementing regulations. Part V addresses the pay versus performance disclosure obligations imposed by Section 953 paragraph a and the substantial regulatory development that culminated in the 2022 final rule. Part VI examines the clawback obligations imposed by Section 954 and the implementing listing standards. Part VII addresses the hedging policy disclosure obligations imposed by Section 955 and the implementing

regulations.[4] Part VIII examines Section 162 paragraph m of the Internal Revenue Code and the disclosure obligations imposed by Item 402 of Regulation S K. Part IX addresses the fiduciary obligations of compensation committees under state corporate law and the comparative perspective on executive compensation regulation across jurisdictions. Part X concludes with observations regarding the contributions of foreign trained counsel to contemporary executive compensation practice.[5]

II. Say on Pay Under Section 951

Section 951 of the Dodd Frank Act amended Section 14A of the Securities Exchange Act of 1934 to require that public companies provide shareholders with periodic advisory votes on executive compensation, commonly known as say on pay votes.[6] The provision requires that issuers conduct say on pay votes at least once every three years, that they conduct say on frequency votes at least once every six years to determine the frequency of say on pay votes, and that they disclose the results of these votes in their periodic reports. The provision also requires that issuers provide shareholders with separate advisory votes on certain golden parachute compensation arrangements in connection with mergers, sales, and other extraordinary corporate transactions.[7]

The Securities and Exchange Commission adopted final rules implementing Section 951 in January 2011, with the rules becoming effective for shareholder meetings occurring on or after January 21, 2011. The final rules address the substantive requirements applicable to say on pay votes, the procedural requirements applicable to the conduct of such votes, the disclosure obligations applicable to the results, and various other matters relating to the implementation of the provision.[8] The rules provide that say on pay votes are advisory and do not bind the issuer, the board of directors, or the compensation committee, and that the results of the votes do not create or imply any change in the fiduciary obligations of the directors or the compensation committee. The advisory character of the votes has substantial implications for the legal effect of

the votes, although the practical influence of negative or marginal votes on subsequent compensation practice is substantial.[9]

The implementation of say on pay has had substantial implications for the conduct of executive compensation practice at United States public companies. Issuers have substantially increased the depth and quality of compensation disclosure provided in proxy statements, including the development of executive summary sections that distill the principal compensation arrangements and rationales, the provision of detailed analysis of the relationship between compensation and corporate performance, and the engagement with shareholders regarding compensation matters.[10] Compensation committees have substantially increased their engagement with shareholders, including through direct meetings with major institutional investors regarding compensation arrangements, the consideration of feedback from shareholders in compensation decisions, and the integration of shareholder perspectives into the design of compensation programs. The development of best practices for shareholder engagement on compensation matters has been a substantial component of contemporary corporate governance practice.[11]

The proxy advisory firms, including Institutional Shareholder Services and Glass Lewis, have developed substantial methodologies for the analysis of executive compensation in connection with say on pay recommendations. These methodologies typically include quantitative analyses of the relationship between compensation and corporate performance, qualitative analyses of compensation program design and governance, and various other components that inform the recommendations of the proxy advisory firms. The substantial influence of the proxy advisory firm recommendations on institutional investor voting has substantially shaped corporate engagement with the firms, with issuers frequently engaging with the firms regarding compensation analyses and seeking to address concerns identified in the recommendations.[12]

The empirical evidence regarding the effects of say on pay is substantial and continues to develop. Studies have addressed the relationship between say on pay outcomes and subsequent

compensation practice, the influence of say on pay on the design of compensation programs, the effects of say on pay on shareholder value, and various other dimensions of the implementation of the requirement.[13] The accumulated evidence suggests that say on pay has had substantial effects on compensation practice, with issuers responding to negative or marginal vote outcomes through subsequent modifications to compensation programs and through enhanced engagement with shareholders. The ongoing development of empirical evidence and academic analysis regarding say on pay continues to inform the engagement of regulators, issuers, and investors with the implementation of the requirement.[14]

III. Compensation Committee Independence Under Section 952

Section 952 of the Dodd Frank Act amended Section 10C of the Securities Exchange Act of 1934 to require that the national securities exchanges adopt listing standards relating to the independence of compensation committees and the consultants and advisers retained by such committees.[15] The provision requires the exchanges to adopt standards addressing the composition of compensation committees, the authority of compensation committees to retain advisers, the independence of advisers retained by compensation committees, the consideration of independence factors in the selection of advisers, and the disclosure of conflicts of interest involving compensation consultants. The Securities and Exchange Commission adopted final rules implementing Section 952 in June 2012, and the New York Stock Exchange and the Nasdaq Stock Market subsequently adopted listing standards implementing the requirement.[16]

The compensation committee independence requirements address the composition of compensation committees of listed companies, requiring that all members satisfy enhanced independence requirements that go beyond the general independence requirements applicable to directors. The enhanced independence requirements consider, among other factors, the source of compensation paid to the director by the issuer including any consulting, advisory, or other fees,

and any affiliation of the director with the issuer or any subsidiary of the issuer. The application of these requirements requires careful analysis of the relationships of compensation committee members with the issuer and may result in restrictions on the service of particular directors on the compensation committee.[17]

The compensation committee adviser independence requirements address the independence of consultants, legal counsel, and other advisers retained by compensation committees. The requirements provide that compensation committees must consider specified independence factors before retaining advisers, including the provision of other services to the issuer by the adviser or the adviser's firm, the amount of fees received from the issuer relative to the adviser firm's total revenues, the policies and procedures of the adviser firm regarding conflicts of interest, business or personal relationships of the adviser with members of the compensation committee, and stock ownership of the adviser in the issuer. The consideration of these factors does not preclude the retention of advisers that present concerns under the factors but requires that compensation committees engage substantively with the independence considerations.[18]

The implementation of the Section 952 requirements has substantially shaped the operation of compensation committees and their engagement with advisers. Compensation committees have substantially increased their direct engagement with the selection and oversight of advisers, including through formal consideration of independence factors prior to retention, ongoing assessment of adviser independence, and the documentation of these considerations in committee minutes and proxy statement disclosure.[19] The compensation consulting industry has substantially developed practices designed to address the independence considerations, including through the establishment of formal independence policies, the management of potential conflicts of interest, and the provision of detailed information regarding adviser relationships with the issuer. The disclosure obligations applicable to compensation consultant relationships, including

the disclosure of conflicts of interest in the proxy statement, have substantially shaped the practices of issuers and consultants.[20]

IV. Pay Ratio Disclosure Under Section 953 Paragraph b

Section 953 paragraph b of the Dodd Frank Act amended Item 402 of Regulation S K to require that public companies disclose the ratio of the annual total compensation of the chief executive officer to the annual total compensation of the median employee.[21] The Securities and Exchange Commission adopted final rules implementing this provision in August 2015, with the rules becoming effective for fiscal years beginning on or after January 1, 2017. The implementation of the pay ratio disclosure has been one of the more contested components of the Dodd Frank Act executive compensation reforms, with substantial debate regarding the analytical methodology, the practical burdens of compliance, and the comparability of the disclosed ratios across issuers.[22]

The pay ratio disclosure rules address the methodology for the identification of the median employee, the calculation of annual total compensation for both the chief executive officer and the median employee, the form and content of the disclosure, and various other matters relating to the implementation of the requirement. The rules provide issuers with substantial flexibility in the identification of the median employee, including the use of statistical sampling and consistently applied compensation measures, with the consequence that the methodology applied may vary substantially across issuers. The rules require disclosure of the methodology applied to identify the median employee, the calculation of annual total compensation, and the resulting ratio, with the consequence that investors can assess the methodology applied by particular issuers and consider the implications for the comparability of disclosed ratios.[23]

The implementation of the pay ratio disclosure has generated substantial debate regarding the analytical and policy questions raised by the requirement. Supporters of the requirement have

emphasized the importance of disclosing information regarding the relationship between executive and broader employee compensation, the contribution of the disclosure to broader public discussion of compensation matters, and the potential influence of the disclosure on compensation practice. Critics have emphasized the substantial costs of compliance, the limitations of the disclosed ratios as comparable measures across issuers with different workforce structures, the susceptibility of the methodology to manipulation, and the limited analytical value of the disclosed information for investment decisions.[24] The empirical evidence regarding the effects of the pay ratio disclosure on compensation practice and on investor decision making continues to develop, and the broader assessment of the implementation of the requirement remains an area of ongoing analysis.

V. Pay Versus Performance Disclosure Under Section 953 Paragraph a

Section 953 paragraph a of the Dodd Frank Act amended Section 14A of the Securities Exchange Act of 1934 to require that issuers disclose information regarding the relationship between executive compensation actually paid and the financial performance of the issuer.[25] The implementation of this provision proceeded over a substantially extended period, with the Securities and Exchange Commission proposing rules in 2015 and adopting final rules in August 2022, more than twelve years after the enactment of the Dodd Frank Act. The final rules address the calculation of compensation actually paid, the financial performance measures to be disclosed, the form and content of the disclosure, and various other matters relating to the implementation of the requirement.[26]

The pay versus performance disclosure requires that issuers provide a tabular presentation showing, for each of the most recently completed five fiscal years, the compensation actually paid to the principal executive officer and the average compensation actually paid to the other named executive officers, along with specified performance measures including total shareholder return

for the issuer and a peer group, net income, and a company selected measure that the issuer considers to be the most important financial performance measure for linking compensation to performance. The disclosure must also include narrative analysis of the relationships between compensation actually paid and the disclosed performance measures, with substantial flexibility in the form and content of the analysis.[27]

The calculation of compensation actually paid under the pay versus performance disclosure requirements differs substantially from the calculation of compensation reported in the Summary Compensation Table under Item 402 of Regulation S K. Compensation actually paid for purposes of the pay versus performance disclosure includes adjustments to the compensation reported in the Summary Compensation Table to reflect the change in fair value of equity awards from grant date to vesting date, the inclusion of dividends paid on unvested equity awards, and various other adjustments designed to provide a more direct measure of the compensation that is connected to performance. The methodology generates substantial differences between the figures reported in the Summary Compensation Table and the figures reported as compensation actually paid, with implications for the practical interpretation of the disclosed information.[28]

The implementation of the pay versus performance disclosure has generated substantial discussion regarding the analytical methodology, the practical implementation of the requirement, and the implications for compensation practice. The first proxy season in which the requirement applied generated substantial commentary from issuers, investors, and proxy advisory firms regarding the practical implementation, the comparability of disclosures across issuers, and the implications for the assessment of compensation practice. The ongoing development of practice regarding the pay versus performance disclosure continues, with issuers, investors, and advisers refining their approaches to the requirement and the broader assessment of its implementation.[29]

VI. Clawback Obligations Under Section 954

Section 954 of the Dodd Frank Act added Section 10D to the Securities Exchange Act of 1934 to require that the national securities exchanges adopt listing standards requiring listed companies to develop and implement policies for the recovery of erroneously awarded incentive compensation in the event of an accounting restatement.[30] The provision requires that issuers recover incentive compensation paid to current or former executive officers during the three year period preceding the restatement, in amounts representing the compensation that would not have been paid based on the restated financial statements. The Securities and Exchange Commission adopted final rules implementing Section 954 in October 2022, with the listing standards required to be adopted by the exchanges and to become effective for issuers in subsequent periods.[31]

The clawback obligations under Section 954 differ substantially from the clawback obligations under Section 304 of the Sarbanes Oxley Act of 2002. Section 304 of the Sarbanes Oxley Act provides for the recovery by the issuer of certain compensation paid to the chief executive officer and chief financial officer in the event of accounting restatements caused by misconduct, with the recovery enforced by the Securities and Exchange Commission rather than by the issuer. Section 954 of the Dodd Frank Act, by contrast, requires that the issuer itself maintain a clawback policy applicable to all current and former executive officers, with recovery available regardless of whether the restatement was caused by misconduct.[32] The two provisions thus address related but distinct concerns, with Section 304 focused on misconduct based recovery enforced by the Commission and Section 954 focused on broader policy based recovery implemented by the issuer.

The implementation of the Section 954 clawback obligations has generated substantial engagement by issuers, compensation committees, and advisers. Issuers have developed and adopted clawback policies that address the requirements of the listing standards, including the scope of compensation subject to recovery, the methodology for the calculation of the amount subject to recovery, the procedures for the implementation of recovery, and the disclosure

obligations applicable to the policies and to particular recovery actions.[33] The drafting and implementation of clawback policies requires careful attention to the specific requirements of the listing standards, the practical realities of compensation arrangements, and the various legal considerations applicable to the recovery of compensation including state law and contract considerations.[34]

VII. Hedging Policy Disclosure and Other Provisions

Section 955 of the Dodd Frank Act amended Section 14 of the Securities Exchange Act of 1934 to require that issuers disclose, in any proxy or consent solicitation material relating to the election of directors, whether the issuer permits any employees or directors to engage in transactions that are designed to hedge or offset any decrease in the market value of equity securities granted as compensation or held directly or indirectly by the employee or director.[35] The Securities and Exchange Commission adopted final rules implementing this provision in December 2018, with the rules becoming effective for proxy statements filed during fiscal years beginning on or after July 1, 2019. The disclosure obligations apply to all hedging transactions involving equity securities granted as compensation or otherwise held by employees or directors and require the disclosure of the practices or policies of the issuer regarding such transactions.

The implementation of the hedging policy disclosure has generated engagement by issuers regarding the design and disclosure of hedging policies. Many issuers have adopted explicit hedging policies that prohibit certain hedging transactions by employees and directors, with the resulting policies addressing the specific transactions covered, the persons subject to the prohibitions, and the procedures for monitoring and enforcement. The disclosure of these policies in proxy statements has become a routine component of executive compensation disclosure, with issuers providing the disclosure required by the rules and frequently providing additional disclosure regarding the rationale for the policies and the practical implementation.[36]

Various other provisions of the Dodd Frank Act and the implementing regulations address aspects of executive compensation that complement the principal provisions discussed above. These include the proxy disclosure requirements relating to compensation committee independence and the use of compensation consultants under Section 952, the disclosure of internal pay equity considerations under various provisions, the disclosure of compensation arrangements in connection with mergers and other extraordinary transactions under Section 951, and various other provisions that contribute to the overall regulatory architecture applicable to executive compensation. The integration of these various provisions into a coherent regulatory framework, and the practical implementation of the framework by issuers and advisers, is a substantial undertaking that continues to develop through regulatory practice and the engagement of the various participants in the system.[37]

VIII. Section 162 Paragraph m and Item 402 Disclosure

Section 162 paragraph m of the Internal Revenue Code, originally enacted as part of the Omnibus Budget Reconciliation Act of 1993, limits the deductibility for federal income tax purposes of compensation paid by publicly held corporations to certain executive officers.[38] The provision originally limited the deductibility of compensation in excess of one million dollars per covered employee per year, with an exception for performance based compensation that satisfied specified requirements. The Tax Cuts and Jobs Act of 2017 substantially modified Section 162 paragraph m, eliminating the performance based compensation exception, expanding the categories of covered employees, and providing a once a covered employee, always a covered employee rule that perpetuates covered employee status. The substantial modifications introduced by the Tax Cuts and Jobs Act have substantially altered the practical operation of Section 162 paragraph m and have eliminated the historical incentive to structure compensation as performance based to qualify for the deductibility exception.[39]

Item 402 of Regulation S K establishes the disclosure obligations applicable to executive compensation in registration statements, periodic reports, and proxy statements filed with the Securities and Exchange Commission.[40] The Item provides for substantial disclosure regarding compensation arrangements applicable to named executive officers, including the principal executive officer, the principal financial officer, and the three most highly compensated other executive officers. The disclosure obligations include the Compensation Discussion and Analysis, which provides narrative analysis of the compensation programs and the considerations that inform compensation decisions; the Summary Compensation Table, which presents quantitative information regarding compensation paid to named executive officers; and various supplementary tables and disclosures addressing specific elements of compensation including grants of plan based awards, outstanding equity awards, option exercises and stock vested, pension benefits, nonqualified deferred compensation, and termination and change in control arrangements.[41]

The Compensation Discussion and Analysis required by Item 402 paragraph b is the principal narrative disclosure regarding executive compensation and addresses the objectives of the compensation programs, the elements of compensation, the considerations that inform compensation decisions, the relationship between compensation and corporate performance, and various other matters that contextualize the quantitative disclosures provided in the supplementary tables. The Securities and Exchange Commission has issued substantial guidance regarding the Compensation Discussion and Analysis, including in the 2010 release on proxy disclosure enhancements and in various staff guidance documents, and the development of practice regarding the Compensation Discussion and Analysis continues through the engagement of issuers, advisers, and the Commission staff.[42]

IX. Compensation Committee Fiduciary Obligations and Comparative Perspective

The fiduciary obligations of compensation committees under state corporate law, principally the law of Delaware, structure the analysis of director conduct in connection with executive compensation decisions and provide important context for the regulatory framework discussed above. The fiduciary duties of corporate directors, including the duty of care, the duty of loyalty, and the duty of good faith, apply to the conduct of compensation committees in connection with the design, approval, and oversight of compensation arrangements.[43] The business judgment rule provides the default standard of judicial review applicable to compensation decisions, but the standard may shift to enhanced scrutiny or entire fairness review in particular circumstances involving conflicts of interest or other concerns.

The Delaware courts have addressed compensation matters in various decisions including the historical Disney litigation, in which the Delaware Court of Chancery and the Delaware Supreme Court provided substantial guidance regarding the standards applicable to director conduct in compensation decisions. More recent decisions including the Tesla litigation, in which the Delaware Court of Chancery in January 2024 voided a substantial compensation award to the chief executive officer of Tesla on grounds of inadequate process and conflicts of interest, illustrate the ongoing development of compensation related fiduciary duty doctrine.[44] The decisions emphasize the substantial responsibilities of compensation committees in the design and approval of compensation arrangements and the importance of robust process and independent consideration in connection with compensation decisions.

The comparative perspective on executive compensation regulation across jurisdictions reveals substantial variation in approach. The European Union has developed a substantial regulatory framework for executive compensation that includes the Capital Requirements Directive provisions applicable to financial institutions, the Shareholder Rights Directive provisions

applicable to listed companies generally, and various national implementations that address particular dimensions of compensation practice. The United Kingdom maintains a substantial regulatory framework that includes the say on pay provisions of the Companies Act 2006, the Stewardship Code provisions applicable to institutional investor engagement on compensation matters, and various other provisions that address compensation practice.[45] The substantial variation in regulatory approach across jurisdictions creates substantial complexity for issuers with cross border operations and for compensation arrangements applicable to executives operating across multiple jurisdictions.

The integration of cross border considerations into executive compensation practice presents substantial challenges. Issuers with substantial foreign operations face questions regarding the structuring of compensation for executives located in foreign jurisdictions, the integration of compensation programs across jurisdictions with different regulatory frameworks, the management of tax considerations applicable to cross border compensation, and various other matters that require sustained engagement with the cross border dimensions of compensation practice. The development of advisory capacity adequate to these cross border considerations is an ongoing priority for the executive compensation field, and the contributions of foreign trained counsel to the development of this capacity are substantial.[46]

X. Conclusion and Implications for Foreign Trained Counsel

The regulatory architecture governing executive compensation at United States public companies has developed substantially over the past two decades through the enactment of the Sarbanes Oxley Act, the Dodd Frank Act, and the substantial regulatory implementation that has continued through the Securities and Exchange Commission rulemaking. The resulting regulatory framework addresses the substantive design of compensation arrangements, the disclosure of compensation matters, the governance of compensation committees, the relationship between

compensation and corporate performance, and the recovery of compensation in particular circumstances. The framework continues to develop through ongoing regulatory action, judicial interpretation, and the practical engagement of issuers, investors, and advisers.[47]

The contributions that foreign trained counsel can make to the practice of executive compensation law are substantial. The cross border dimensions of contemporary compensation practice, including the structuring of compensation for executives operating across jurisdictions, the integration of compensation programs with the regulatory frameworks of foreign jurisdictions, and the management of cross border tax and regulatory considerations applicable to compensation, are areas in which the cross jurisdictional expertise of foreign trained counsel is particularly valuable.[48] The integration of foreign trained counsel into the legal departments of major issuers, into the compensation consulting and law firms that advise issuers and compensation committees, and into the academic and policy communities that engage with compensation regulation is an important component of the broader development of advisory capacity adequate to contemporary practice.

The Foreign Trained Lawyers Association Law Review aspires to provide a forum for the analytical engagement of foreign trained counsel with the substantive and practical questions that contemporary executive compensation regulation raises. The development of scholarly engagement with these questions, the integration of comparative perspectives into the analysis of compensation practice, and the contribution of foreign trained perspectives to the policy debates concerning the development of compensation frameworks are all components of the broader project that the Law Review seeks to advance. The continued development of advisory and institutional leadership capacity adequate to the cross border dimensions of contemporary executive compensation practice is an ongoing priority, and the contributions of foreign trained counsel to that development are a substantial component of the broader work that the field requires.[49]

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ARTICLE IV

Audit Committee Oversight, the Public Company Accounting Oversight Board, and the Integrity of Financial Reporting at United States Public Companies

By

Tamar Landia

ABSTRACT

This Article examines the regulatory architecture governing audit committee oversight and the integrity of financial reporting at United States public companies. The analysis traces the development of audit committee responsibilities from their origins in the listing standards of the New York Stock Exchange through the substantial reforms introduced by the Sarbanes Oxley Act of 2002 and the subsequent regulatory development by the Securities and Exchange Commission and the Public Company Accounting Oversight Board. The Article examines the audit committee independence requirements imposed by Section 301 of the Sarbanes Oxley Act, the internal control obligations imposed by Section 404, the auditor independence requirements imposed by Section 201, the regulation of the audit profession by the Public Company Accounting Oversight Board, and the substantive responsibilities of audit committees with respect to the integrity of financial reporting, the operation of internal controls, the engagement of the independent auditor, and the oversight of risk management. The Article concludes with observations regarding the contributions of foreign trained counsel to contemporary audit committee practice.

KEYWORDS: audit committee, Sarbanes Oxley Act, Section 404, Public Company Accounting Oversight Board, internal control over financial reporting, auditor independence, financial reporting integrity, Caremark obligations, comparative audit oversight.

I. Introduction

The integrity of financial reporting at United States public companies depends on a substantial regulatory architecture that combines federal statutory and regulatory provisions, listing standards adopted by the national securities exchanges, auditing standards promulgated by the Public Company Accounting Oversight Board, and the practical engagement of audit committees, independent auditors, internal auditors, and corporate management with the operation of financial reporting systems.[1] The architecture has been substantially developed over the past two decades through the Sarbanes Oxley Act of 2002 and the subsequent regulatory implementation, and the resulting framework is among the most substantially developed components of contemporary federal securities regulation.[2]

This Article surveys the regulatory architecture governing audit committee oversight and the integrity of financial reporting at United States public companies, with particular attention to the doctrinal foundations, practical implementation, and ongoing development of the principal regulatory frameworks.[3] Part II addresses the audit committee independence requirements imposed by Section 301 of the Sarbanes Oxley Act and the implementing listing standards. Part III examines the internal control obligations imposed by Section 404 of the Sarbanes Oxley Act and the substantial regulatory development that has followed. Part IV addresses the auditor independence requirements imposed by Section 201 of the Sarbanes Oxley Act and the implementing regulations. Part V examines the regulation of the audit profession by the Public Company Accounting Oversight Board, including the inspection program, the standard setting activity, and the enforcement program.[4] Part VI addresses the substantive responsibilities of audit committees with respect to the integrity of financial reporting, the operation of internal controls, the engagement of the independent auditor, and the oversight of risk management. Part VII examines the application of Caremark obligations to audit committee oversight responsibilities. Part VIII addresses the comparative perspective on audit oversight across

jurisdictions. Part IX concludes with observations regarding the contributions of foreign trained counsel to contemporary audit committee practice.[5]

II. Audit Committee Independence Under Section 301

Section 301 of the Sarbanes Oxley Act of 2002 amended Section 10A of the Securities Exchange Act of 1934 to require that the national securities exchanges adopt listing standards relating to the audit committees of listed companies.[6] The provision requires the exchanges to adopt standards addressing the composition of audit committees, the responsibilities of audit committees with respect to the engagement of the independent auditor, the procedures for the receipt and treatment of complaints regarding accounting matters, the authority of audit committees to engage independent counsel and other advisers, and the funding required for the engagement of the independent auditor and the engagement of advisers by the audit committee.[7] The Securities and Exchange Commission adopted final rules implementing Section 301 in April 2003, and the New York Stock Exchange and the Nasdaq Stock Market adopted listing standards implementing the requirements.

The audit committee independence requirements address the composition of audit committees of listed companies, requiring that all members of the audit committee be independent directors who satisfy specified independence requirements that go beyond the general independence requirements applicable to directors. The enhanced independence requirements provide that audit committee members may not accept any consulting, advisory, or other compensatory fee from the issuer or any subsidiary of the issuer, other than fees received for service as a director or member of a committee of the board, and may not be affiliated persons of the issuer or any subsidiary of the issuer.[8] The application of these requirements requires careful analysis of the relationships of audit committee members with the issuer and may result in restrictions on the service of particular directors on the audit committee.

The audit committee responsibilities required by Section 301 include the direct engagement and oversight of the independent auditor, the establishment of procedures for the receipt and treatment of complaints regarding accounting matters, the authority to engage independent counsel and other advisers, and the funding required for the engagement of the independent auditor and the audit committee advisers. The provision establishes the audit committee as the body responsible for the engagement of the independent auditor, with the consequence that the audit committee, rather than corporate management, is the principal client of the independent auditor with respect to the audit relationship. The substantial implications of this allocation of responsibility for the conduct of the audit relationship and the engagement of the independent auditor with the issuer are central to the operational implementation of the Sarbanes Oxley Act reforms.[9]

The audit committee financial expert requirements imposed by Section 407 of the Sarbanes Oxley Act and the implementing regulations require that issuers disclose whether the audit committee includes at least one member who qualifies as an audit committee financial expert. The qualifications for audit committee financial expert status include specified attributes relating to understanding of generally accepted accounting principles and financial statements, experience in preparing or auditing financial statements, experience with internal accounting controls, and understanding of audit committee functions. The disclosure requirement does not mandate that issuers maintain at least one audit committee financial expert but creates substantial pressure for the inclusion of qualified financial experts on audit committees.[10]

III. Internal Control Obligations Under Section 404

Section 404 of the Sarbanes Oxley Act of 2002 imposes substantial obligations relating to the establishment, maintenance, and assessment of internal control over financial reporting at United States public companies.[11] Section 404 paragraph a requires that issuers include in their annual

reports a report by management on the issuer's internal control over financial reporting, including a statement of management's responsibility for establishing and maintaining adequate internal control over financial reporting, an assessment of the effectiveness of the issuer's internal control over financial reporting as of the end of the issuer's most recent fiscal year, and a disclosure of any material weakness in the issuer's internal control over financial reporting. Section 404 paragraph b requires that the registered public accounting firm preparing or issuing the audit report on the issuer's financial statements attest to and report on the assessment of internal control over financial reporting made by management.[12]

The implementation of Section 404 has been one of the most substantially developed components of the Sarbanes Oxley Act reforms, with substantial regulatory action by the Securities and Exchange Commission and the Public Company Accounting Oversight Board over more than two decades. The Securities and Exchange Commission adopted initial rules implementing Section 404 in 2003, with the rules becoming effective for accelerated filers for fiscal years ending on or after November 15, 2004. The Commission has subsequently issued substantial guidance addressing management's assessment of internal control, including the 2007 interpretive release on Management's Report on Internal Control Over Financial Reporting and Certification of Disclosure in Exchange Act Periodic Reports, which provided guidance designed to make the management assessment more efficient and effective.[13]

The Public Company Accounting Oversight Board has issued auditing standards addressing the audit of internal control over financial reporting, including the foundational Auditing Standard Number 2 issued in 2004 and the subsequent Auditing Standard Number 5 adopted in 2007 in connection with the broader Securities and Exchange Commission and Public Company Accounting Oversight Board engagement with the implementation of Section 404. Auditing Standard Number 5 substantially modified the audit approach applicable to internal control over financial reporting, providing for a more risk based and integrated approach designed to focus

audit attention on areas of greatest risk and to integrate the audit of internal control with the audit of financial statements.[14] The substantial implementation of Auditing Standard Number 5 over the past fifteen years has shaped the operational conduct of internal control audits and the broader engagement of the audit profession with the implementation of Section 404.

The implementation of Section 404 has generated substantial debate regarding the costs and benefits of the requirement, the appropriate scope of the requirement, and the practical implementation of the requirement. The Dodd Frank Act of 2010 amended Section 404 to permanently exempt non accelerated filers from the auditor attestation requirement of Section 404 paragraph b, while retaining the management assessment requirement of Section 404 paragraph a applicable to all reporting issuers. The Jumpstart Our Business Startups Act of 2012 provided additional accommodations for emerging growth companies, including a temporary exemption from the auditor attestation requirement during the period in which the issuer qualifies as an emerging growth company. The substantial accommodations for smaller reporting issuers reflect ongoing regulatory engagement with the appropriate calibration of the Section 404 requirements.[15]

The empirical evidence regarding the effects of Section 404 has been substantial and continues to develop. Studies have addressed the relationship between Section 404 implementation and the integrity of financial reporting, the costs of compliance with the requirement, the effects on the cost of capital, the influence on management practice, and various other dimensions of the implementation. The accumulated evidence suggests that Section 404 has had substantial effects on the integrity of financial reporting and the operation of internal controls, with material weakness disclosures providing investors with information regarding the operation of issuer reporting systems and with management focus on internal control matters substantially increased.[16]

IV. Auditor Independence Under Section 201

Section 201 of the Sarbanes Oxley Act of 2002 amended Section 10A of the Securities Exchange Act of 1934 to prohibit independent auditors of issuers from providing certain non audit services to their audit clients.[17] The provision identifies a list of prohibited non audit services, including bookkeeping or other services related to the accounting records or financial statements of the audit client, financial information systems design and implementation, appraisal or valuation services, fairness opinions or contribution in kind reports, actuarial services, internal audit outsourcing services, management functions or human resources, broker dealer services, investment adviser services, investment banking services, legal services and expert services unrelated to the audit, and any other service the Public Company Accounting Oversight Board determines, by regulation, is impermissible. The provision also requires that any non audit services provided by the independent auditor that are not prohibited be approved in advance by the audit committee.[18]

The Securities and Exchange Commission adopted final rules implementing Section 201 in January 2003, and the rules have been substantially developed through subsequent regulatory action, staff guidance, and enforcement practice. The implementing rules address the specific scope of the prohibited services, the application of the rules to particular fact patterns, the requirements applicable to the pre approval of non prohibited services by the audit committee, the requirements relating to partner rotation, and various other matters relating to the auditor independence framework.[19] The Public Company Accounting Oversight Board has also adopted standards addressing auditor independence and has periodically issued additional guidance regarding the application of the independence framework to particular circumstances.

The implementation of the auditor independence framework has substantially shaped the relationship between independent auditors and their audit clients. The audit firms have substantially restructured their service offerings to address the independence requirements, with

substantial separation of audit and non audit services and substantial constraints on the provision of non audit services to audit clients. The audit committees have developed substantial pre approval policies and procedures, including specific pre approval of particular engagements, general pre approval of categories of engagements within specified parameters, periodic monitoring of engagements, and the disclosure of fees paid to the independent auditor in proxy statements. The substantial regulatory engagement with auditor independence continues to develop through ongoing standard setting, enforcement, and the practical implementation of the framework.[20]

V. The Public Company Accounting Oversight Board

The Public Company Accounting Oversight Board, established by Title I of the Sarbanes Oxley Act of 2002, is the principal regulatory body responsible for the oversight of audit firms that audit the financial statements of United States public companies and certain other regulated entities.[21] The Board exercises substantial regulatory authority over the audit profession, including the authority to register audit firms that audit public companies, to inspect the work of registered audit firms, to establish auditing and related professional practice standards, to investigate and discipline registered audit firms and associated persons for violations of applicable standards and laws, and to perform such other duties or functions as the Board determines are necessary or appropriate.[22]

The inspection program of the Public Company Accounting Oversight Board is the principal mechanism through which the Board monitors the audit work performed by registered audit firms. The Board conducts inspections of audit firms registered with the Board, with the frequency of inspections determined by the size of the firm. Audit firms that audit more than one hundred issuers annually are inspected on an annual basis, while audit firms that audit one hundred or fewer issuers annually are inspected at least once every three years. The inspections involve substantial review

of audit work performed by the firm, including review of audit engagements selected by the Board and review of the firm's quality control system.[23] The Board issues inspection reports addressing the results of the inspections, with portions of the reports made public and other portions, including criticism of the firm's quality control system, made public only if the firm fails to remediate the criticism within a specified period.

The standard setting activity of the Public Company Accounting Oversight Board has produced a substantial body of auditing and related professional practice standards that govern the conduct of audits of issuers and other regulated entities. The Board's standards address audit planning, audit risk, materiality, audit evidence, audit reporting, audit committee communications, related parties, internal control audits, and various other dimensions of audit practice. The Board has also adopted ethics and independence standards that supplement the Securities and Exchange Commission auditor independence rules. The development of the Board's standards has involved substantial engagement with the audit profession, the Securities and Exchange Commission, and other interested parties, and the resulting standards represent a substantial component of the regulatory architecture applicable to the audit profession.[24]

The enforcement program of the Public Company Accounting Oversight Board addresses violations of applicable standards and laws by registered audit firms and associated persons. The Board may impose sanctions including the revocation of registration, the imposition of monetary penalties, the prohibition or suspension of associated persons from association with registered audit firms, and various other sanctions. The enforcement program has produced a substantial body of disciplinary action over the past two decades, addressing violations of audit standards, independence requirements, and other applicable provisions. The substantial enforcement activity by the Board, in addition to the substantial enforcement activity by the Securities and Exchange Commission, contributes to the overall framework of accountability for audit quality at registered audit firms.[25]

VI. Substantive Responsibilities of Audit Committees

The substantive responsibilities of audit committees of public companies, as developed through the Sarbanes Oxley Act, the implementing regulations, the listing standards of the national securities exchanges, and the practical engagement of audit committees with their oversight responsibilities, address several distinguishable dimensions of corporate financial reporting and risk management.[26] The first dimension involves the engagement and oversight of the independent auditor, including the selection of the independent auditor, the negotiation of the audit engagement, the review of the audit plan, the engagement with the independent auditor regarding the conduct of the audit, the consideration of audit findings, the assessment of the effectiveness of the independent auditor, and the determination regarding the retention or replacement of the independent auditor. The audit committee discharge of these responsibilities involves substantial direct engagement with the independent auditor, including private meetings between the audit committee and the independent auditor without the presence of management.

The second dimension of audit committee responsibility involves the oversight of internal control over financial reporting, including the engagement with management regarding the design and operation of internal control, the consideration of management's assessment of internal control, the consideration of the independent auditor's attestation to and report on management's assessment of internal control, the engagement with internal audit regarding the testing of internal control, and the consideration of any material weakness or significant deficiency identified through the various processes. The audit committee oversight of internal control is a substantial component of the practical implementation of Section 404 and requires sustained engagement by audit committee members with the operation of internal control systems.[27]

The third dimension of audit committee responsibility involves the oversight of the financial reporting process, including the engagement with management regarding the preparation of financial statements, the consideration of significant accounting policies and estimates, the

consideration of unusual or non recurring transactions, the consideration of changes in accounting principles, the consideration of regulatory developments affecting financial reporting, and the engagement with the independent auditor regarding the audit of the financial statements. The audit committee oversight of the financial reporting process requires substantial direct engagement with the financial reporting function and with the chief financial officer and other financial reporting personnel.[28]

The fourth dimension of audit committee responsibility involves the oversight of internal audit, including the consideration of the internal audit charter and authority, the approval of the internal audit plan, the engagement with internal audit regarding the conduct of audit work, the consideration of internal audit findings, the assessment of the effectiveness of the internal audit function, and the determination regarding internal audit leadership. The audit committee oversight of internal audit involves substantial direct engagement with the chief internal auditor and the broader internal audit function, including private meetings between the audit committee and the internal audit leadership.[29]

The fifth dimension of audit committee responsibility, increasingly elaborated in recent years, involves the oversight of risk management as it relates to the financial reporting and broader compliance function. While risk management responsibilities are frequently shared between the audit committee and other board committees, including risk committees where they exist and the full board, the audit committee typically retains substantial responsibility for risk management as it relates to the integrity of financial reporting and the operation of compliance programs. The audit committee discharge of risk management responsibilities requires sustained engagement with the risk management function, including the chief risk officer, the chief compliance officer, and the broader compliance and risk management infrastructure of the issuer.[30]

The audit committee responsibilities for non generally accepted accounting principles measures and other non standard financial measures have become increasingly significant in recent

years. Issuers frequently report financial measures that supplement the measures prepared in accordance with generally accepted accounting principles, including various adjusted measures that may exclude particular items from the corresponding generally accepted accounting principles measures. The Securities and Exchange Commission has adopted regulations and issued guidance addressing the disclosure of non generally accepted accounting principles measures, including Regulation G, Item 10 paragraph e of Regulation S K, and various staff guidance, and audit committees have substantial responsibilities for the oversight of the disclosure of non generally accepted accounting principles measures including the consistency of the measures with the regulatory framework, the prominence of the measures relative to corresponding generally accepted accounting principles measures, and the disclosure of reconciliation information.[31]

VII. Caremark Obligations and Audit Committee Oversight

The Caremark obligations articulated by the Delaware Court of Chancery in In re Caremark International Inc. Derivative Litigation provide a substantial component of the fiduciary doctrine applicable to audit committee oversight. The Caremark decision established that directors have an obligation to assure themselves that information and reporting systems exist in the organization that are reasonably designed to provide timely, accurate information sufficient to allow management and the board to reach informed judgments concerning the corporation's compliance with law and its business performance. The application of Caremark obligations to audit committee oversight, given the central role of audit committees in oversight of financial reporting and compliance functions, raises substantial questions regarding the adequacy of audit committee oversight in particular circumstances.[32]

The Delaware courts have in recent years substantially elaborated the application of Caremark obligations through decisions including Marchand v. Barnhill in 2019, City of Birmingham Retirement and Relief System v. Good in 2017, and Inter Marketing Group USA, Inc. v. Armstrong

in 2020. These decisions have addressed the requirements for the establishment of information and reporting systems with respect to mission critical risks, the obligations of directors with respect to red flags that may indicate problems with information and reporting systems, and the application of Caremark to particular fact patterns including food safety, environmental compliance, and pharmaceutical product safety.[33] The substantial development of Caremark doctrine over the past several years has elevated the practical importance of director oversight obligations and has implications for the conduct of audit committee oversight.

The application of Caremark obligations to audit committee oversight requires substantial attention to the design and operation of information and reporting systems with respect to financial reporting and compliance matters. Audit committees must satisfy themselves that the issuer has established information and reporting systems adequate to provide them with the information necessary to discharge their oversight responsibilities, including with respect to financial reporting matters, internal control matters, compliance with applicable laws and regulations, and other matters within the audit committee's oversight responsibility. Audit committees must also engage substantively with red flags or other indications of problems that may emerge through the various information and reporting channels available to the committee, including direct communications from the independent auditor, internal audit reports, compliance reports, whistleblower complaints, and other sources of information regarding potential problems.[34]

VIII. Comparative Perspective on Audit Oversight

The comparative perspective on audit oversight across jurisdictions reveals substantial variation in approach. The European Union has developed a substantial regulatory framework for audit firms and audit committees that includes the Statutory Audit Directive and the Statutory Audit Regulation, both substantially revised in 2014 in response to the financial crisis. The European framework includes provisions addressing audit firm rotation, the prohibition of certain

non audit services, the regulation of audit committees, the establishment of competent authorities responsible for the regulation of audit firms, and various other matters relating to the audit profession.[35] The United Kingdom maintains a regulatory framework that includes the Financial Reporting Council, which serves as the regulatory body for the audit profession and the broader financial reporting framework, and the substantial framework of the United Kingdom Corporate Governance Code, which addresses audit committee responsibilities and broader governance matters.

The international convergence of audit oversight frameworks has been substantial over the past two decades, with substantial coordination among national regulators through the International Forum of Independent Audit Regulators and other coordinating bodies. The International Federation of Accountants and its standard setting boards, including the International Auditing and Assurance Standards Board, have developed international auditing standards that have been substantially adopted by national regulators in many jurisdictions. The Public Company Accounting Oversight Board has engaged substantially with foreign regulators regarding the inspection of foreign audit firms that audit issuers reporting to the Securities and Exchange Commission, with the resulting cooperative arrangements addressing substantial questions regarding the application of the Board's authority to firms operating in foreign jurisdictions.[36]

The integration of cross border considerations into audit committee practice presents substantial challenges. Issuers with substantial foreign operations face questions regarding the structure of audit relationships across jurisdictions, the engagement of component auditors, the integration of audit work across multiple jurisdictions, the management of independence considerations applicable to audit relationships in foreign jurisdictions, and various other matters that require sustained engagement with the cross border dimensions of audit practice. The development of advisory capacity adequate to these cross border considerations is an ongoing

priority for the audit and audit committee field, and the contributions of foreign trained counsel to the development of this capacity are substantial.[37]

IX. Conclusion and Implications for Foreign Trained Counsel

The regulatory architecture governing audit committee oversight and the integrity of financial reporting at United States public companies has developed substantially over the past two decades through the Sarbanes Oxley Act, the substantial regulatory implementation by the Securities and Exchange Commission and the Public Company Accounting Oversight Board, and the practical engagement of audit committees, independent auditors, and corporate management with the operational implementation of the framework.[38] The resulting framework addresses the composition and independence of audit committees, the obligations relating to internal control over financial reporting, the regulation of the audit profession and the auditor independence framework, and the substantive responsibilities of audit committees with respect to the integrity of financial reporting, the operation of internal controls, the engagement of the independent auditor, and the oversight of risk management.

The contributions that foreign trained counsel can make to the practice of audit committee law and the broader field of audit oversight are substantial. The cross border dimensions of contemporary audit practice, including the engagement of component auditors operating in foreign jurisdictions, the integration of audit work across multiple jurisdictions, the management of independence considerations applicable to audit relationships in foreign jurisdictions, and the practical implementation of audit committee oversight responsibilities for issuers with substantial foreign operations, are areas in which the cross jurisdictional expertise of foreign trained counsel is particularly valuable.[39] The integration of foreign trained counsel into the legal departments of major issuers, into the law firms that advise issuers and audit committees, into the audit firms themselves, and into the academic and policy communities that engage with audit oversight is an

important component of the broader development of advisory capacity adequate to contemporary practice.

The Foreign Trained Lawyers Association Law Review aspires to provide a forum for the analytical engagement of foreign trained counsel with the substantive and practical questions that contemporary audit oversight raises. The development of scholarly engagement with these questions, the integration of comparative perspectives into the analysis of audit practice, and the contribution of foreign trained perspectives to the policy debates concerning the development of audit frameworks are all components of the broader project that the Law Review seeks to advance. The continued development of advisory and institutional leadership capacity adequate to the cross border dimensions of contemporary audit oversight is an ongoing priority, and the contributions of foreign trained counsel to that development are a substantial component of the broader work that the field requires.[40]

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ARTICLE V

Offer and Acceptance in Contemporary Contract Law: The Doctrinal Foundations of Contract Formation, the Battle of the Forms, and the Treatment of Electronic and Standardized Agreements Under United States Law

By

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ABSTRACT

This Article examines the doctrinal foundations of contract formation under United States law, with particular attention to the rules governing offer and acceptance, the treatment of standardized form contracts, and the developments in contract formation arising from electronic contracting and online consumer transactions. The analysis traces the historical foundations of offer and acceptance doctrine in the common law and the Restatement (Second) of Contracts, examines the modifications introduced for the sale of goods by Article 2 of the Uniform Commercial Code including the substantial reforms of Section 2 to 207 governing the battle of the forms, addresses the rules governing the timing and manner of acceptance including the mailbox rule and its modern application, and examines the substantial body of case law that has developed regarding the enforceability of clickwrap, browsewrap, and other electronic agreements.

KEYWORDS: offer and acceptance, contract formation, mailbox rule, battle of the forms, Uniform Commercial Code Section 2 to 207, clickwrap agreements, browsewrap agreements, electronic contracts, Restatement of Consumer Contracts, comparative contract formation

I. Introduction

The doctrinal framework governing the formation of contracts under United States law is among the most foundational components of the legal system, with the rules governing offer and acceptance providing the basic mechanism through which the law identifies the moment at which contractual obligation is created and the substantive content of the resulting agreement.[1] The framework has developed over more than two centuries through the common law, the work of the American Law Institute in the Restatement of Contracts and the Restatement (Second) of Contracts, the modifications introduced by Article 2 of the Uniform Commercial Code for the sale of goods, and the substantial body of judicial decisions that have applied and elaborated the doctrinal framework to particular fact patterns. The framework continues to develop through ongoing engagement with the substantial transformations in commercial practice arising from electronic contracting, online consumer transactions, and the substantial use of standardized form agreements in contemporary commerce.[2]

This Article surveys the doctrinal foundations of contract formation under United States law, with particular attention to the rules governing offer and acceptance and the substantial developments in those rules arising from contemporary commercial practice.[3] Part II addresses the historical foundations of offer and acceptance doctrine and the principal sources of contemporary contract formation law. Part III examines the rules governing offers, including the requirements for the formation of an offer and the rules governing the revocation, rejection, and lapse of offers. Part IV addresses the rules governing acceptance, including the requirements for effective acceptance and the application of the mailbox rule.[4] Part V examines the substantial reforms introduced by Section 2 to 207 of the Uniform Commercial Code addressing the battle of the forms in commercial transactions for the sale of goods. Part VI addresses the substantial body of doctrine regarding the enforceability of clickwrap, browsewrap, and other electronic agreements. Part VII examines the application of contract formation doctrine to consumer

protection circumstances and the developments arising from the Restatement of Consumer Contracts. Part VIII addresses the comparative perspective on contract formation across jurisdictions. Part IX concludes with observations regarding the contributions of foreign trained counsel to contemporary contract law practice.[5]

II. Historical Foundations and Sources of Contract Formation Law

The historical foundations of offer and acceptance doctrine in the United States trace to the common law of England as received by the American colonies and the early Republic, with the substantial development of the doctrine through the nineteenth century jurisprudence of the state courts.[6] The American jurisprudential tradition has produced a substantial body of decisional authority regarding contract formation, with the substantial decisions of the New York Court of Appeals, the Massachusetts Supreme Judicial Court, the California Supreme Court, and various other state courts contributing to the doctrinal development. The treatise tradition, including the substantial works of Williston on Contracts and Corbin on Contracts, has provided substantial scholarly engagement with the doctrinal framework and has contributed to the development of practice and the elaboration of the framework.

The Restatement of Contracts, originally adopted by the American Law Institute in 1932, provided the first comprehensive scholarly synthesis of contract law and contributed substantially to the development of practice and the elaboration of the doctrinal framework. The Restatement (Second) of Contracts, adopted in 1981, substantially modified and elaborated the original Restatement and provides the principal contemporary scholarly synthesis of general contract law in the United States. The Restatement (Second) addresses contract formation through Sections 17 through 70, covering the requirements for contract formation, the rules governing offers, the rules governing acceptance, the rules governing the revocation of offers, and various other matters.[7]

The Uniform Commercial Code, adopted by all states in some form, modifies the common law contract formation rules for transactions involving the sale of goods. Article 2 of the Code, which addresses the sale of goods, includes provisions modifying the rules governing offer and acceptance, the mirror image rule, the battle of the forms, the parol evidence rule, the statute of frauds, and various other matters. The substantial modifications introduced by Article 2 reflect the distinctive considerations applicable to commercial transactions for the sale of goods and have been the subject of substantial judicial and academic engagement over more than half a century.[8]

The United Nations Convention on Contracts for the International Sale of Goods, ratified by the United States and a substantial number of other countries, provides an additional source of contract formation law applicable to international sale of goods transactions. The Convention establishes a framework for contract formation in international transactions that differs in various respects from the framework established by the Uniform Commercial Code, with the consequence that the contract formation analysis applicable to particular transactions may depend on whether the transaction is governed by the Convention, the Uniform Commercial Code, or other applicable law. The substantial body of jurisprudence and scholarly engagement with the Convention has continued to develop over the past several decades.[9]

III. The Formation of Offers

An offer is the manifestation of willingness to enter into a bargain, made in a manner that justifies another person in understanding that his assent to that bargain is invited and will conclude it.[10] The Restatement (Second) of Contracts identifies the requirements for the formation of an offer through this formulation in Section 24, with the substantial elaboration of the requirements through subsequent provisions and the substantial body of decisional authority. The principal requirements for the formation of an offer include the manifestation of willingness to enter into a bargain, the communication of the manifestation to the offeree, the inclusion of terms sufficiently

definite to permit the formation of an enforceable contract upon acceptance, and the indication that acceptance will conclude the bargain without further negotiation or assent by the offeror.

The distinction between offers and preliminary negotiations is a substantial component of the doctrinal framework. The Restatement (Second) of Contracts and the substantial body of decisional authority distinguish offers, which create a power of acceptance in the offeree, from preliminary negotiations, which constitute mere invitations to make offers and do not themselves create a power of acceptance. The application of this distinction to particular fact patterns requires substantial attention to the manifestations of the parties, the context of the communications, and the customary practices of the relevant trade or industry. The substantial body of decisional authority addressing this distinction has produced a substantial set of considerations that inform the analysis in particular cases.[11]

The treatment of advertisements, price lists, catalogs, and similar communications has been a particular subject of doctrinal development. The general rule is that such communications constitute invitations to make offers rather than offers themselves, with the consequence that a customer responding to such a communication makes an offer that the merchant may accept or reject. The general rule is subject to exceptions, including circumstances in which the communication is sufficiently specific in its terms and indications of intent to constitute an offer rather than a mere invitation. The leading case of Lefkowitz v. Great Minneapolis Surplus Store, decided by the Minnesota Supreme Court in 1957, illustrates the application of the exception in the context of a particularly specific and clear communication that the court treated as an offer rather than a mere invitation.[12]

The rules governing the revocation, rejection, and lapse of offers are substantial components of the doctrinal framework. The general rule is that an offer may be revoked at any time before acceptance, with the revocation becoming effective upon receipt by the offeree, except in circumstances in which the offer is supported by an option contract or otherwise rendered

irrevocable. The rules regarding rejection provide that an offer may be rejected by the offeree, with the rejection terminating the power of acceptance, and that a counter offer made by the offeree generally constitutes a rejection of the original offer. The rules regarding lapse provide that an offer terminates upon the lapse of the time specified in the offer or, in the absence of a specified time, upon the lapse of a reasonable time. The substantial body of decisional authority addressing these rules has produced a substantial set of considerations that inform the analysis in particular cases.[13]

The doctrine of firm offers, codified in Section 2 to 205 of the Uniform Commercial Code for transactions involving the sale of goods, provides that a written offer made by a merchant to buy or sell goods, signed by the merchant and giving assurance that it will be held open, is not revocable for the time stated or, if no time is stated, for a reasonable time, with such period of irrevocability not to exceed three months. The firm offer doctrine modifies the common law rule that an offer is generally revocable in the absence of consideration supporting an option contract and provides commercial parties with a mechanism for creating irrevocable offers without the formality of an option contract.[14]

IV. The Rules Governing Acceptance

Acceptance is the manifestation of assent to the terms of an offer in the manner invited or required by the offer.[15] The Restatement (Second) of Contracts addresses acceptance through Sections 50 through 70, with the principal provisions addressing the requirements for effective acceptance, the manner of acceptance, the timing of acceptance, the application of the mailbox rule, and various other matters. The principal requirements for effective acceptance include the manifestation of assent to the terms of the offer, the communication of the manifestation to the offeror in the manner invited or required by the offer, and the conformity of the acceptance with the terms of the offer.

The mirror image rule, which has been a substantial component of the common law of contract formation, provides that an acceptance must be the unqualified assent to the terms of the offer, with the consequence that any variation in the terms of the acceptance from the terms of the offer constitutes a counter offer rather than an acceptance. The mirror image rule reflects the historical view that the formation of a contract requires the meeting of the minds of the parties on the same terms and that any variation in terms reflects a failure to achieve such a meeting. The substantial application of the mirror image rule has produced a substantial body of decisional authority addressing particular fact patterns and has informed the substantial reforms introduced by Section 2 to 207 of the Uniform Commercial Code for transactions involving the sale of goods.[16]

The mailbox rule, which has been a substantial component of the common law of contract formation since the decision in Adams v. Lindsell in 1818, provides that an acceptance becomes effective upon dispatch by the offeree rather than upon receipt by the offeror, with the consequence that the contract is formed at the moment the acceptance is placed in the mail or otherwise dispatched. The rule applies in circumstances in which the offer invites or authorizes acceptance by mail or by similar means and the acceptance is dispatched in the manner invited or authorized by the offer. The application of the mailbox rule has been a subject of substantial judicial development, with the substantial body of decisional authority addressing particular fact patterns and the application of the rule to circumstances involving electronic communications and other contemporary methods of communication.[17]

The application of the mailbox rule to electronic communications has been a subject of substantial recent development. The general view in the contemporary scholarly literature and the developing decisional authority is that the mailbox rule may apply to certain electronic communications, including in particular email communications, although the application of the rule to particular electronic communications depends on various factors including the manner of communication invited or authorized by the offer, the customary practices of the relevant context,

and the substantive considerations applicable to the analysis. The Uniform Electronic Transactions Act, adopted by most states, provides additional rules governing the timing of electronic communications that may interact with the application of the mailbox rule.[18]

The treatment of acceptance by silence is a particular subject of doctrinal development. The general rule is that silence does not constitute acceptance, with the consequence that an offeror may not impose contractual obligation on an offeree merely by stating that the offeree's failure to respond will be deemed acceptance. The general rule is subject to exceptions, including circumstances in which the offeree has indicated that silence will constitute acceptance, circumstances in which the offeree takes the benefit of services with reasonable opportunity to reject them and reason to know that the services were offered with the expectation of compensation, and circumstances in which prior dealings between the parties have established silence as a manner of acceptance. The substantial body of decisional authority addressing these exceptions has produced a substantial set of considerations that inform the analysis in particular cases.[19]

V. The Battle of the Forms Under Section 2 to 207

Section 2 to 207 of the Uniform Commercial Code, addressing the battle of the forms in commercial transactions for the sale of goods, modifies the common law mirror image rule to address the practical realities of commercial contracting in which parties exchange standardized forms with terms that may vary in various respects.[20] The Section provides that a definite and seasonable expression of acceptance or a written confirmation that is sent within a reasonable time operates as an acceptance even though it states terms additional to or different from those offered or agreed upon, unless acceptance is expressly made conditional on assent to the additional or different terms. The provision substantially modifies the mirror image rule and addresses the

practical commercial circumstance in which parties intend to form a contract notwithstanding variations in the terms of their forms.

The treatment of additional terms under Section 2 to 207 paragraph 2 differs depending on whether the parties are merchants. Between merchants, additional terms become part of the contract unless the offer expressly limits acceptance to the terms of the offer, the additional terms materially alter the contract, or notification of objection has already been given or is given within a reasonable time. The application of the materially alter standard has been a subject of substantial judicial development, with the substantial body of decisional authority addressing particular categories of additional terms including arbitration clauses, warranty disclaimers, indemnification provisions, choice of forum provisions, and various other matters.[21]

The treatment of different terms under Section 2 to 207 paragraph 2 has been a subject of substantial judicial and academic disagreement. The principal approaches include the knockout rule, under which different terms cancel each other out and the contract consists of the agreed terms supplemented by the gap filling provisions of Article 2; the offeror approach, under which different terms in the acceptance are dropped and the contract consists of the offeror's terms; and various intermediate approaches that have been adopted by particular jurisdictions. The substantial diversity of judicial approaches to different terms has generated substantial commercial uncertainty and has been the subject of substantial scholarly engagement.[22]

The treatment of contract formation through conduct under Section 2 to 207 paragraph 3 addresses circumstances in which the writings of the parties do not establish a contract but the conduct of the parties recognizes the existence of a contract. In such circumstances, the contract consists of those terms on which the writings of the parties agree, together with any supplementary terms incorporated under any other provisions of the Uniform Commercial Code. The provision addresses the practical commercial circumstance in which parties commence performance notwithstanding the absence of agreement on the terms of their writings, with the consequence that

a contract is formed by the conduct of the parties and the terms of that contract are determined by reference to the writings and to the gap filling provisions of Article 2.[23]

VI. Electronic Contracts and the Enforceability of Clickwrap and Browsewrap Agreements

The substantial development of electronic contracting in the United States has produced a substantial body of doctrine and practice regarding the enforceability of clickwrap, browsewrap, and other electronic agreements.[24] The Electronic Signatures in Global and National Commerce Act, enacted by Congress in 2000, provides that electronic signatures and electronic records satisfy applicable requirements for signatures and records under various federal and state laws, with the consequence that electronic agreements are generally given the same legal effect as paper agreements. The Uniform Electronic Transactions Act, adopted by most states, provides similar provisions at the state level. The combination of these statutory provisions, together with the substantial body of judicial decisions addressing electronic agreements, has produced a substantial framework governing the enforceability of electronic contracts.

Clickwrap agreements, which require the user to take some affirmative action such as clicking a button or checking a box to manifest assent to the terms of the agreement, have generally been held enforceable by courts that have addressed the question. The leading cases including Specht v. Netscape Communications Corp., decided by the Court of Appeals for the Second Circuit in 2002, and Nguyen v. Barnes and Noble, Inc., decided by the Court of Appeals for the Ninth Circuit in 2014, have addressed the enforceability of clickwrap agreements and have generally upheld their enforceability where the user has been provided with notice of the terms and has manifested assent through an affirmative action. The substantial body of decisional authority addressing clickwrap agreements has produced a substantial set of considerations that inform the analysis of particular agreements.[25]

Browsewrap agreements, which purport to bind users to terms based on their use of a website without requiring any affirmative manifestation of assent to the terms, have been treated more skeptically by courts. The general approach is that browsewrap agreements are enforceable only where the user has actual or constructive notice of the terms, with the substantial body of decisional authority addressing the requirements for actual or constructive notice. The leading cases including Nguyen v. Barnes and Noble, Inc. have addressed the enforceability of browsewrap agreements and have generally found them unenforceable in circumstances in which the user has not been provided with adequate notice of the terms. The substantial body of decisional authority addressing browsewrap agreements has produced a substantial set of considerations that inform the analysis of particular agreements.[26]

The substantial development of intermediate forms of electronic agreement, including in particular sign in wrap and scrollwrap agreements, has presented additional questions regarding the enforceability of electronic contracts. Sign in wrap agreements, which present the terms of an agreement together with a sign in or registration button and indicate that clicking the button constitutes assent to the terms, have generally been treated as similar to clickwrap agreements for purposes of enforceability analysis. Scrollwrap agreements, which require the user to scroll through the entire text of the agreement before clicking an assent button, have generally been treated favorably for purposes of enforceability analysis because of the substantial demonstration of opportunity to review the terms.[27]

The application of contract formation doctrine to mass market consumer transactions, including in particular online consumer transactions involving standardized form agreements, has presented substantial questions regarding the requirements for adequate notice and assent. The substantial body of decisional authority addressing these questions has emphasized the importance of providing users with clear and prominent notice of the terms of the agreement, requiring the user to take an affirmative action to manifest assent to the terms, and avoiding practices that may

be considered inadequate to provide actual or constructive notice. The development of best practices for electronic contract formation continues to evolve through ongoing decisional authority and industry practice.[28]

VII. Consumer Contracts and the Restatement of Consumer Contracts

The application of contract formation doctrine to consumer protection circumstances has been a subject of substantial development over the past several decades.[29] The substantial use of standardized form agreements in consumer transactions, including in particular consumer financial services agreements, consumer technology service agreements, and consumer e commerce agreements, has produced a substantial body of doctrine and practice regarding the formation and enforceability of such agreements. The combination of contract formation doctrine, consumer protection statutes including the Federal Trade Commission Act and various state consumer protection statutes, and the substantial body of judicial decisions addressing consumer contracts has produced a substantial framework governing consumer contract formation.

The American Law Institute adopted the Restatement of Consumer Contracts in 2024 following more than a decade of development. The Restatement provides a synthesis of the law applicable to consumer contracts, including the rules governing the formation of consumer contracts, the rules governing the modification of consumer contracts, the rules governing the unenforceability of consumer contract terms in various circumstances, and various other matters. The Restatement has been the subject of substantial debate during its development, with substantial differences of view regarding the appropriate framework for the regulation of consumer contracts and the appropriate balance between contract formation principles and consumer protection considerations.[30]

The principal provisions of the Restatement of Consumer Contracts address the formation of consumer contracts through provisions that recognize the substantial use of standardized form

agreements in consumer transactions and provide rules for determining the enforceability of terms in such agreements. The Restatement provides that consumer contracts may be formed through manifestation of assent to standardized terms, with the assent established through various means including affirmative action such as clicking a button, continued use of a service after notice of the terms, and various other manifestations of assent. The Restatement also provides rules for the unenforceability of particular terms in consumer contracts, including provisions addressing terms that are unconscionable, terms that violate public policy, and various other categories of unenforceable terms.[31]

The application of contract formation doctrine to consumer arbitration agreements has been a particular subject of substantial doctrinal development. The substantial body of decisional authority addressing consumer arbitration agreements has addressed the enforceability of such agreements under the Federal Arbitration Act, the application of unconscionability doctrine to particular arbitration provisions, the enforceability of class action waivers in consumer arbitration agreements, and various other matters. The substantial body of decisional authority including the leading cases of AT and T Mobility LLC v. Concepcion in 2011, American Express Co. v. Italian Colors Restaurant in 2013, and Epic Systems Corp. v. Lewis in 2018 has substantially shaped the framework governing consumer arbitration agreements and continues to develop through ongoing decisional authority.[32]

VIII. Comparative Perspective on Contract Formation

The comparative perspective on contract formation across jurisdictions reveals substantial variation in approach.[33] The civil law tradition, as represented by the contract law of most European Union member states, addresses contract formation through provisions that differ substantially from the common law tradition in various respects. The principal differences include the approach to the requirements for the formation of an offer, the treatment of revocation of offers

prior to acceptance, the treatment of additional or different terms in acceptances, and various other matters. The substantial differences between the common law and civil law approaches to contract formation generate substantial complexity for international commercial transactions and require sustained engagement with the multiple frameworks applicable to particular transactions.

The United Nations Convention on Contracts for the International Sale of Goods, ratified by the United States and a substantial number of other countries, provides an additional source of contract formation law applicable to international sale of goods transactions. The Convention establishes a framework for contract formation in international transactions that combines elements of the common law and civil law traditions, with various distinctive features reflecting the compromises made during the development of the Convention. The Convention rules regarding offer and acceptance, the treatment of additional or different terms in acceptances, the timing of acceptance, and various other matters differ in various respects from both the common law and the civil law approaches.[34]

The principles of European contract law, as represented by the Principles of European Contract Law and the proposed Common European Sales Law, have addressed the harmonization of contract formation rules across European Union member states with various distinctive features. The substantial development of European contract law harmonization has reflected both the practical commercial considerations applicable to cross border transactions within the European Union and the broader development of European Union legal integration. The substantial scholarly engagement with European contract law harmonization has produced a substantial body of analysis that contributes to the comparative engagement with contract formation across jurisdictions.[35]

The integration of cross border considerations into contract formation practice presents substantial challenges. Transactions involving parties in multiple jurisdictions face questions regarding the choice of law applicable to contract formation, the application of the rules of the chosen jurisdiction, the integration of the rules of the chosen jurisdiction with the substantive

considerations applicable to the transaction, and various other matters. The development of advisory capacity adequate to these cross border considerations is an ongoing priority for the contract law field, and the contributions of foreign trained counsel to the development of this capacity are substantial.[36]

IX. Conclusion and Implications for Foreign Trained Counsel

The doctrinal framework governing the formation of contracts under United States law has developed substantially over more than two centuries through the common law, the work of the American Law Institute in the Restatement of Contracts and the Restatement (Second) of Contracts, the modifications introduced by Article 2 of the Uniform Commercial Code for the sale of goods, the substantial body of judicial decisions that have applied and elaborated the doctrinal framework, and the more recent developments arising from electronic contracting and consumer protection considerations.[37] The resulting framework addresses the rules governing offers, the rules governing acceptance, the application of the mailbox rule and its modern variants, the substantial reforms introduced by Section 2 to 207 of the Uniform Commercial Code, the substantial body of doctrine regarding the enforceability of clickwrap, browsewrap, and other electronic agreements, and the application of contract formation doctrine to consumer protection circumstances.

The contributions that foreign trained counsel can make to the practice of contract law are substantial. The cross border dimensions of contemporary contract practice, including the integration of contract formation rules across jurisdictions, the application of the United Nations Convention on Contracts for the International Sale of Goods to international transactions, the management of choice of law considerations in cross border transactions, and the practical implementation of contract formation principles in transactions involving multiple jurisdictions, are areas in which the cross jurisdictional expertise of foreign trained counsel is particularly

valuable.[38] The integration of foreign trained counsel into the legal departments of major commercial enterprises, into the law firms that advise on commercial contracts, into the academic and policy communities that engage with contract law, and into the various other institutions that contribute to the development of contract law practice is an important component of the broader development of advisory capacity adequate to contemporary practice.

The Foreign Trained Lawyers Association Law Review aspires to provide a forum for the analytical engagement of foreign trained counsel with the substantive and practical questions that contemporary contract law raises. The development of scholarly engagement with these questions, the integration of comparative perspectives into the analysis of contract law practice, and the contribution of foreign trained perspectives to the policy debates concerning the development of contract law are all components of the broader project that the Law Review seeks to advance. The continued development of advisory and institutional leadership capacity adequate to the cross border dimensions of contemporary contract practice is an ongoing priority, and the contributions of foreign trained counsel to that development are a substantial component of the broader work that the field requires.[39]

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ARTICLE VI

Insider Trading Regulation, Material Nonpublic Information, and the Tipping Doctrine: Doctrinal Foundations and Enforcement Practice Under United States Federal Securities Law

By

Sopiko Gugava

ABSTRACT

This Article examines the doctrinal foundations and enforcement practice of insider trading regulation under United States federal securities law. The analysis traces the development of the doctrine through the principal Supreme Court decisions establishing the classical theory in Chiarella v. United States and Dirks v. SEC, the misappropriation theory in United States v. O'Hagan, the tipping doctrine through Dirks and the subsequent line of cases including Salman v. United States, the establishment of the personal benefit requirement and its application in cases including United States v. Newman and the subsequent line of cases through United States v. Blaszczak. The Article examines Rule 10b5 sub paragraph 1 trading plans and the substantial 2022 amendments to that rule, the application of Section 16 paragraph b short swing profit recovery, the regulatory framework for selective disclosure under Regulation Fair Disclosure, and the comparative perspective on insider trading regulation. The Article concludes with observations regarding the contributions of foreign trained counsel to contemporary insider trading practice.

KEYWORDS: insider trading, Rule 10b 5, classical theory, misappropriation theory, tipping doctrine, personal benefit, Rule 10b5 sub paragraph 1 plans, Section 16 paragraph b, Regulation Fair Disclosure, comparative insider trading regulation

I. Introduction

Insider trading regulation under United States federal securities law has developed through a substantial body of judicial and regulatory authority that addresses the trading of securities on the basis of material nonpublic information by persons in particular relationships of trust, confidence, or fiduciary obligation.[1] The doctrine has developed primarily through judicial interpretation of Section 10 paragraph b of the Securities Exchange Act of 1934 and Rule 10b 5 promulgated thereunder, supplemented by regulatory rulemaking by the Securities and Exchange Commission, the Insider Trading Sanctions Act of 1984, the Insider Trading and Securities Fraud Enforcement Act of 1988, the Sarbanes Oxley Act of 2002, and various other regulatory and statutory developments. The resulting doctrinal framework, while substantially developed, continues to evolve through ongoing judicial decisions and regulatory engagement, and the practical application of the doctrine to particular fact patterns continues to generate substantial analytical and enforcement engagement.[2]

This Article surveys the doctrinal foundations and enforcement practice of insider trading regulation under United States federal securities law, with particular attention to the Supreme Court decisions establishing the principal theories of liability, the application of the doctrine to tipping circumstances, the practical mechanisms through which insider trading regulation operates, and the comparative perspective on insider trading regulation across jurisdictions.[3] Part II addresses the historical development of insider trading doctrine and the establishment of the classical theory in Chiarella v. United States. Part III examines the misappropriation theory established in United States v. O'Hagan. Part IV addresses the tipping doctrine through Dirks v. SEC and the substantial subsequent development. Part V examines the personal benefit requirement and the substantial doctrinal development through United States v. Newman, Salman v. United States, and United States v. Blaszczak. Part VI addresses Rule 10b5 sub paragraph 1 trading plans and the substantial 2022 amendments. Part VII examines Section 16 paragraph b

short swing profit recovery. Part VIII addresses Regulation Fair Disclosure and the regulation of selective disclosure. Part IX examines the comparative perspective on insider trading regulation. Part X concludes with observations regarding the contributions of foreign trained counsel to contemporary insider trading practice.[4]

II. The Classical Theory and Chiarella v. United States

The classical theory of insider trading liability, established by the Supreme Court of the United States in Chiarella v. United States in 1980, holds that a person violates Section 10 paragraph b and Rule 10b 5 by trading on material nonpublic information in breach of a duty arising from a relationship of trust and confidence between that person and the shareholders of the corporation whose securities are being traded.[5] The Chiarella decision held that the duty arises from the relationship between corporate insiders and the shareholders of the corporation and that persons who do not stand in such a relationship to the corporation do not have a duty to disclose or abstain from trading. The decision substantially shaped the development of insider trading doctrine by establishing that liability requires the breach of a specific fiduciary duty rather than the mere possession and use of material nonpublic information.

The Chiarella decision arose from the conduct of Vincent Chiarella, an employee of a financial printer who traded on the basis of information about pending tender offers that he learned through his work for the printer. The Court of Appeals for the Second Circuit had affirmed Chiarella's conviction on the basis that he had a duty to disclose the information to the persons with whom he traded. The Supreme Court reversed, holding that Chiarella did not have such a duty because he was not in a fiduciary relationship with the shareholders from whom he purchased securities. The decision established the foundational principle that insider trading liability under Section 10 paragraph b requires the breach of a specific fiduciary duty.[6]

The Chiarella decision left open substantial questions regarding the scope of insider trading liability, including the application of the doctrine to persons who obtain material nonpublic information through means other than the corporate insider relationship. The Securities and Exchange Commission responded to these questions through the adoption of Rule 14e 3 in 1980, which prohibits trading on material nonpublic information regarding tender offers in circumstances that may be broader than those covered by Section 10 paragraph b. The rule has been substantially elaborated through subsequent enforcement actions and judicial decisions and provides a substantial component of the regulatory framework applicable to trading in connection with tender offers.[7]

III. The Misappropriation Theory and United States v. O'Hagan

The misappropriation theory of insider trading liability, established by the Supreme Court of the United States in United States v. O'Hagan in 1997, holds that a person violates Section 10 paragraph b and Rule 10b 5 by misappropriating material nonpublic information from a source to whom the person owes a duty of trust and confidence and trading on the basis of that information.[8] The O'Hagan decision substantially expanded the scope of insider trading liability by recognizing that the breach of a duty owed to a source of information, rather than to the shareholders of the corporation whose securities are traded, can support liability under Section 10 paragraph b. The decision was significant for the application of insider trading liability to persons who obtain material nonpublic information through means other than the corporate insider relationship.

The O'Hagan decision arose from the conduct of James O'Hagan, a partner at a law firm representing a tender offeror, who traded on the basis of information about the pending tender offer that he learned through his firm's representation of the offeror. The Court of Appeals for the Eighth Circuit had reversed O'Hagan's conviction on the basis that the misappropriation theory was not

viable under Section 10 paragraph b. The Supreme Court reversed the Eighth Circuit, holding that the misappropriation theory satisfies the in connection with element of Section 10 paragraph b because the misappropriation involves a breach of duty in connection with the purchase or sale of securities.[9]

The O'Hagan decision substantially shaped the development of insider trading doctrine by establishing the misappropriation theory as a basis for liability and by addressing several substantial doctrinal questions regarding the application of Section 10 paragraph b to circumstances involving the breach of duties owed to sources of information. The decision has been substantially elaborated through subsequent enforcement actions and judicial decisions, with the application of the misappropriation theory to particular fact patterns continuing to generate doctrinal development. The decision has also informed the Securities and Exchange Commission's adoption of Rule 10b5 sub paragraph 2, which articulates particular relationships in which the duties of trust and confidence required for misappropriation liability may arise.[10]

IV. The Tipping Doctrine and Dirks v. SEC

The tipping doctrine, established by the Supreme Court of the United States in Dirks v. SEC in 1983, addresses the liability of persons who receive material nonpublic information from corporate insiders or other persons subject to disclosure or abstention obligations.[11] The Dirks decision held that a tippee acquires liability when the tipper has breached a fiduciary duty to the source of the information by disclosing the information to the tippee and the tippee knows or should know that there has been such a breach. The decision established that the tipping liability of the tippee is derivative of the tipping liability of the tipper, requiring proof of the tipper's breach as a foundational element of the tippee's liability.

The Dirks decision arose from the conduct of Raymond Dirks, a securities analyst who received information about fraudulent practices at Equity Funding Corporation of America from a

former officer of the company and disseminated the information to clients of his firm. The Securities and Exchange Commission found that Dirks had violated the federal securities laws by trading on the information through his clients. The Supreme Court reversed, holding that the breach of duty by the tipper, which is a foundational element of the tippee's liability, requires that the tipper personally benefit from the disclosure to the tippee. The personal benefit requirement, articulated in Dirks and substantially elaborated in subsequent decisions, has been a central component of tipping doctrine.[12]

The Dirks decision identified several categories of personal benefit that may satisfy the requirement, including pecuniary benefits, reputational benefits that may translate into future pecuniary benefits, and the gift like benefit of disclosing information to a relative or friend. The articulation of these categories has substantially shaped the application of the personal benefit requirement to particular fact patterns, and the substantial subsequent doctrinal development has elaborated on the application of the requirement to circumstances ranging from family relationships to friendships to professional networking relationships.[13]

V. The Personal Benefit Requirement and Subsequent Doctrinal Development

The personal benefit requirement articulated in Dirks has been substantially elaborated through subsequent judicial decisions, with the principal subsequent developments occurring in United States v. Newman in the Second Circuit in 2014, Salman v. United States in the Supreme Court in 2016, and the broader line of cases addressing the application of the requirement to particular fact patterns.[14] The Newman decision held that the personal benefit requirement requires proof of an exchange that is objective, consequential, and represents at least a potential gain of a pecuniary or similarly valuable nature, and that in the case of disclosure to a friend the personal benefit must include a meaningfully close personal relationship that generates an exchange that is objective and consequential.[15]

The Salman decision modified the Newman analysis by holding that the personal benefit requirement is satisfied when an insider makes a gift of confidential information to a trading relative or friend. The Supreme Court held that the gift like benefit identified in Dirks does not require proof of additional pecuniary or similarly valuable benefit beyond the gift relationship itself, with the consequence that family disclosures and friendly disclosures can satisfy the requirement on the basis of the gift relationship.[16] The Salman decision substantially limited the Newman analysis to its facts and clarified the application of the personal benefit requirement to family and friendship circumstances.

The line of cases following Salman has continued to elaborate the application of the personal benefit requirement to particular fact patterns. The Second Circuit decision in United States v. Martoma in 2017, addressing the application of Newman and Salman to a particular tipping fact pattern, provided substantial elaboration of the personal benefit requirement and its application to circumstances involving payments and other indicia of benefit. The Supreme Court declined review of Martoma, leaving in place the Second Circuit's application of the personal benefit requirement to the particular facts of that case.[17]

The decision in United States v. Blaszczak in the Second Circuit in 2019, addressing the application of insider trading doctrine to information misappropriated from the Centers for Medicare and Medicaid Services, raised substantial questions regarding the application of the misappropriation theory and the personal benefit requirement to information obtained from government sources. The Supreme Court vacated the Second Circuit decision in 2020 in light of its decision in Kelly v. United States, with the Second Circuit on remand reaching a result that has been the subject of subsequent litigation. The substantial litigation regarding Blaszczak has continued to develop the application of insider trading doctrine to information obtained from various sources beyond traditional corporate insider relationships.[18]

VI. Rule 10b5 Sub Paragraph 1 Trading Plans

Rule 10b5 sub paragraph 1, adopted by the Securities and Exchange Commission in 2000, establishes an affirmative defense to insider trading liability for trades made pursuant to a written plan adopted by a person who is not aware of material nonpublic information.[19] The rule provides that a person who adopts a written trading plan in good faith at a time when the person is not aware of material nonpublic information has an affirmative defense against insider trading liability for trades made pursuant to the plan, even if the person possesses material nonpublic information at the time of the trades. The rule was designed to facilitate trading by corporate insiders who may possess material nonpublic information from time to time but who wish to engage in periodic trading on a basis that does not raise insider trading concerns.

The Securities and Exchange Commission substantially modified Rule 10b5 sub paragraph 1 in December 2022, with the modifications becoming effective for plans adopted on or after February 27, 2023.[20] The modifications address several concerns that had emerged regarding the operation of the rule, including the use of overlapping plans, the use of single trade plans, the timing between plan adoption and the first trade under the plan, and the disclosure of plan adoptions and modifications. The modifications include a cooling off period requirement of ninety days for officers and directors and thirty days for other persons between the adoption or modification of a plan and the first trade under the plan, restrictions on overlapping plans and single trade plans, certifications by officers and directors at the time of plan adoption or modification, and disclosure obligations applicable to plan adoptions and modifications.[21]

The implementation of the modified rule has generated substantial operational engagement by issuers, officers, directors, and their advisers. The development of compliant plans, the management of cooling off periods, the maintenance of compliance with the restrictions on overlapping and single trade plans, the management of certifications by officers and directors, and the implementation of the disclosure obligations all require careful attention to the requirements

of the modified rule. The substantial operational engagement with the modified rule continues to develop, with issuers, officers, directors, and their advisers refining their approaches to the requirements over time.[22]

VII. Section 16 Paragraph b Short Swing Profit Recovery

Section 16 paragraph b of the Securities Exchange Act of 1934 establishes a strict liability framework for the recovery of profits realized by directors, officers, and significant shareholders of issuers from short swing trading in the issuer's equity securities.[23] The provision requires the disgorgement to the issuer of profits realized from the purchase and sale, or sale and purchase, of equity securities of the issuer within any period of less than six months. The provision applies regardless of whether the trading was based on material nonpublic information and regardless of the intent of the person engaging in the trading, with the strict liability character of the provision distinguishing it from the intent based liability of Section 10 paragraph b and Rule 10b 5.

The application of Section 16 paragraph b to particular fact patterns has been substantially elaborated through judicial decisions and the rules promulgated by the Securities and Exchange Commission. The Commission has adopted Rule 16b 3 establishing exemptions for certain transactions involving the issuer, including grants of compensation in compliance with specified requirements, and various other rules addressing particular categories of transactions. The judicial decisions addressing Section 16 paragraph b have addressed the calculation of profits, the matching of purchases and sales for purposes of profit calculation, the application of the provision to derivatives and equity equivalents, and various other matters.[24]

The reporting obligations under Section 16 paragraph a, requiring directors, officers, and significant shareholders to file initial statements of beneficial ownership on Form 3, statements of changes in beneficial ownership on Form 4, and annual statements on Form 5, complement the substantive provisions of Section 16 paragraph b by providing a public record of the trading

activity of these persons. The Sarbanes Oxley Act of 2002 substantially modified the timing requirements applicable to Form 4 filings, generally requiring the filing within two business days of the transaction. The substantial subsequent regulatory development has continued to shape the operation of the Section 16 reporting framework.[25]

VIII. Regulation Fair Disclosure

Regulation Fair Disclosure, adopted by the Securities and Exchange Commission in August 2000, addresses the selective disclosure of material nonpublic information by issuers to securities market professionals and certain other persons.[26] The regulation prohibits issuers from disclosing material nonpublic information to specified categories of recipients, including broker dealers, investment advisers, investment companies, and holders of the issuer's securities under circumstances in which it is reasonably foreseeable that the recipient will purchase or sell the issuer's securities, unless the disclosure is made simultaneously to the public. The regulation was designed to address concerns regarding the selective disclosure of material information to securities market professionals and the implications of such disclosure for the integrity of the securities markets.

The regulation provides various exemptions and accommodations addressing particular circumstances, including disclosures to persons who owe a duty of trust or confidence to the issuer, disclosures pursuant to a confidentiality agreement, disclosures in the course of registered offerings, disclosures in the ordinary course of business activities such as customer relationships, and various other matters. The implementation of the regulation has substantially shaped the practices of issuers, securities analysts, and institutional investors, with substantial transformation of the historical practice of selective disclosure to the analyst community and the development of more public disclosure practices designed to comply with the regulation.[27]

The enforcement of Regulation Fair Disclosure has been substantial over the past two decades, with the Securities and Exchange Commission addressing various categories of violations through enforcement actions. The enforcement activity has addressed selective disclosures in connection with one on one meetings with analysts and investors, selective disclosures through electronic communications, and various other categories of selective disclosure. The substantial enforcement activity has substantially shaped issuer practices and has contributed to the development of best practices for the management of communications with securities market professionals and investors.[28]

IX. Comparative Perspective on Insider Trading Regulation

The comparative perspective on insider trading regulation across jurisdictions reveals substantial variation in approach. The European Union has developed a substantial regulatory framework through the Market Abuse Regulation, originally adopted in 2014 and substantially elaborated through subsequent regulatory action.[29] The European framework includes prohibitions on insider trading, market manipulation, and the unlawful disclosure of inside information, with substantial differences from the United States framework including the absence of the personal benefit requirement applicable to tipping liability and the parity of information based approach to certain dimensions of the doctrine. The substantial differences between the European and United States frameworks generate substantial complexity for cross border activity and for issuers operating across both jurisdictions.

The United Kingdom maintains a regulatory framework that combines elements of the European framework, retained following the United Kingdom's exit from the European Union, with various United Kingdom specific provisions. The Financial Conduct Authority serves as the principal regulatory body for insider trading regulation in the United Kingdom and has developed substantial regulatory practice addressing the various dimensions of insider trading and market

abuse. The United Kingdom regulatory framework addresses similar concerns to those addressed by the European and United States frameworks, with various distinctive features reflecting the particular regulatory tradition of the United Kingdom and the substantial role of London as a center of securities market activity.[30]

Other jurisdictions including Japan, Hong Kong, Singapore, Australia, and various other markets maintain regulatory frameworks for insider trading that vary substantially in approach and substance. The international coordination of insider trading regulation, including through the International Organization of Securities Commissions and various bilateral and multilateral cooperation arrangements, has been substantial over the past two decades and continues to develop through ongoing engagement. The substantial variation across jurisdictions and the integration of cross border considerations into insider trading practice present ongoing challenges that require sustained engagement with the various regulatory frameworks.[31]

The application of United States insider trading doctrine to circumstances involving foreign issuers, foreign markets, or foreign actors presents distinctive analytical challenges. The Morrison v. National Australia Bank decision in 2010 addressed the extraterritorial application of Section 10 paragraph b and established that the provision applies to transactions in securities listed on domestic exchanges and domestic transactions in other securities. The application of Morrison to insider trading cases involving foreign elements has continued to develop through subsequent judicial decisions and has implications for the practical application of insider trading doctrine to circumstances involving cross border activity.[32]

X. Conclusion and Implications for Foreign Trained Counsel

The doctrinal foundations and enforcement practice of insider trading regulation under United States federal securities law have developed substantially over the past four decades through the principal Supreme Court decisions, the substantial subsequent judicial development, the regulatory

rulemaking by the Securities and Exchange Commission, and the ongoing enforcement activity by the Commission and the Department of Justice.[33] The resulting framework addresses the classical theory of liability, the misappropriation theory of liability, the tipping doctrine and the personal benefit requirement, the operation of Rule 10b5 sub paragraph 1 trading plans, the strict liability framework of Section 16 paragraph b, the regulation of selective disclosure under Regulation Fair Disclosure, and the comparative dimensions of insider trading regulation across jurisdictions.

The contributions that foreign trained counsel can make to the practice of insider trading law are substantial. The cross border dimensions of contemporary insider trading practice, including the application of United States doctrine to circumstances involving foreign elements, the integration of United States doctrine with the regulatory frameworks of foreign jurisdictions, the management of cross border investigations and enforcement, and the practical implementation of compliance programs adequate to cross border circumstances, are areas in which the cross jurisdictional expertise of foreign trained counsel is particularly valuable.[34] The integration of foreign trained counsel into the legal departments of major issuers, into the law firms that handle insider trading matters, into the compliance functions of investment advisers and other regulated entities, and into the academic and policy communities that engage with insider trading regulation is an important component of the broader development of advisory capacity adequate to contemporary practice.

The Foreign Trained Lawyers Association Law Review aspires to provide a forum for the analytical engagement of foreign trained counsel with the substantive and practical questions that contemporary insider trading regulation raises. The development of scholarly engagement with these questions, the integration of comparative perspectives into the analysis of insider trading practice, and the contribution of foreign trained perspectives to the policy debates concerning the development of insider trading frameworks are all components of the broader project that the Law

Review seeks to advance. The continued development of advisory and institutional leadership capacity adequate to the cross border dimensions of contemporary insider trading practice is an ongoing priority, and the contributions of foreign trained counsel to that development are a substantial component of the broader work that the field requires.[35]

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VOLUME I * 2026

Published by the

Foreign Trained Lawyers Association

New York, New York