Sidley Perspectives
ON M&A AND CORPORATE GOVERNANCE

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IN THIS ISSUE

ANALYSIS

WARREN BUFFETT'S IDEA FOR BETTER CORPORATE GOVERNANCE—DUELING EXPERTS

By Jennifer Fonner Fitchen[1]

Warren Buffett recently noted in Berkshire Hathaway's annual report that when a board considers an M&A transaction, "the deck is stacked in favor of the deal that's coveted by the CEO and his or her obliging staff. It would be an interesting exercise for a company to hire two 'expert' acquisition advisors, one pro and one con, to deliver his or her views on a proposed deal to the board—with the winning advisor to receive, say, ten times a token sum paid to the loser."[2] Would that approach foster a better environment for corporate governance and improve director decision-making? Let's look at the pros and cons.

Arguments in Favor

- The second adviser acts as a counter-weight to the first adviser whose compensation may be tied to a success fee.
- The board benefits from a broader perspective.
- Emphasis is on board evaluation rather than deference to CEO conclusions.

Arguments Against

- Each adviser's conclusion is pre-determined, incentivizing the two most zealous arguments, creating bias, particularly if "winning" is required to receive a meaningful fee.
- Unless you still have a third adviser presenting a more nuanced analysis, the board loses that judgment from a trusted adviser.
- Directors' time is spent evaluating the merits of two partisan arguments, rather than thoughtfully deliberating after getting the benefit of the judgment of an adviser unconstrained by the conclusion they have been instructed to reach.

At its core, the proposal raises the issue of how a board can best reach the "right" answer for stockholders in an acquisition context. The pro/con adviser approach suggests that the process should be akin to a trial. This theory says that differing views presented in fierce opposition for the judge and jury will expose weakness and uncover "truth." In this adversarial process, neither side provides pros and cons to its own theories or evidence, or shares what it really thinks of its case.

Another Approach

A less partisan approach would have the deal team engage in a "red team" exercise with a subgroup of the board, management and/or advisers, presenting their most compelling "con" argument. This method still uses competing perspectives as a tool, but not to the exclusion of considered judgment applied to analysis developed free from a pre-determined conclusion.

While management and advisers may carry bias, assessing and addressing that impact should be intuitive, and no more challenging for the board to evaluate than the issues presented by the deal itself. One could view "red teaming" as a slightly more intense form of deal deliberation than is already common practice for boards in fulfilling their fiduciary duties to stockholders, one that values the exercise of genuinely advancing contrary positions, as well as the value of thoughtful judgment, candidly shared.

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2 Letter from Warren E. Buffett to the Shareholders of Berkshire Hathaway Inc., dated February 22, 2020, available here.

As to whether Buffett believes the board room should act as a courtroom, there may be a clue to that later in the report. He shares: "At Berkshire, we will continue to look for business-savvy directors who are owner-oriented…Thought and principles, not robot-like 'process,' will guide their actions."

WHEN CEOS SPEAK UP

By Holly J. Gregory[3]

Corporate leaders appear to be speaking out more frequently on matters of social and political importance. Whether this CEO activism is a natural extension of corporate social responsibility or a reaction to an increasingly polarized political environment, recent survey data indicate that the public expects leadership from CEOs on key social issues. In an online survey of 1,006 consumers, Weber Shandwick and KRC Research (*3rd Annual Survey of CEO Activism*, published in July 2018) found that 77% of respondents agreed that CEOs should speak out when their company's values are violated or threatened, and nearly half (48%) agreed that companies should take positions on social issues they consider important to their workforce and to society, even if not directly related to the business. Such activity is not without risk.

While CEO activism may positively influence purchasing decisions among consumers who share the view espoused, with nearly half of respondents (46%) saying they would be more likely to buy from a company led by a CEO who speaks out on an issue they agree with, there is a risk of losing sales to consumers who disagree with the CEO's stated position (45%).

Practical Guidance

Corporations and their executive leadership have long played a role in U.S. politics through quiet lobbying activities and contributions. However, in the current polarized political environment, CEOs are engaging more publicly on sensitive social and political issues of a type that they may have avoided in the past, including issues that are not necessarily directly related to the company's business. Examples of issues that have given rise to "CEO activism" include:

- Hate speech, for example, as evidenced in the protests and conflict in Charlottesville, Virginia.
- Climate change denial and related policy.
- Anti-LGBTQ+ laws and policies.
- The "zero-tolerance" immigration policy and family separations at the southern U.S. border.
- Gun violence.

Because a CEO's public statements and activity on potentially divisive issues will be closely associated with the company, boards need to consider how to provide oversight with respect to such activity.

How a CEO responds to sensitive social and political issues will vary, and there is a risk that constituents may be offended when a corporate leader takes a stand, especially when the link between the issue and the corporation's immediate business interests is unclear. However, failure to take a position on some issues may also expose a company to criticism. Because a CEO's public statements and activity on potentially divisive issues will be closely associated with the company, boards need to consider how to provide oversight with respect to such activity. Care needs to be taken in determining what issues to speak out on, under what circumstances and whether to act individually or in concert with like-minded business leaders.

Boards should discuss with the CEO expectations about how such decisions are made, and consider processes similar to those used for determinations on corporate political contributions and lobbying activities, with the understanding that at times a decision may

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need to be made in a very short time frame. This effort may be undertaken by a group of key executives including the CEO, the general counsel and relevant leaders in internal and external communications, government and community relations, employee and investor relations, and marketing to:

- Identify political or social issues that the company should consider taking a position on, both in reaction to current events and proactively.
- Determine which issues are directly connected to the company's interests and in line with the company's core corporate values.
- Assess potential benefits and risks associated with taking a position on a certain issue (*e.g.*, through engagement with employees, customers or suppliers), in consultation with communications and policy experts as appropriate.
- Identify in advance a response team and protocol to:
  - assess and prepare the company's response to an issue;
  - seek broad consensus internally as appropriate;
  - articulate why the issue is important to the company and the CEO (or not appropriate for company action if the decision is to not engage);
  - address questions from key constituents about the company's reasoning; and
  - assess and manage the impact once a position is taken, including procedures for managing negative reactions from employees, customers and suppliers.
- Consider how the board will be kept informed generally, and in what circumstances input from the board or a designated board committee or member will be sought prior to taking positions on issues that could pose harm to the company's business or reputation. In addition, the board should carefully consider what level of discretion and authority to provide the CEO with respect to speaking out on sensitive issues.

On an issue that could have a material impact on the business or its reputation, care should be taken to involve the board so as to avoid surprises and position the board to support the CEO's actions. Whether or not the board is actively involved in determining whether to speak out on an issue, the decision-making process should incorporate the following:

- **Corporate relations and authenticity.** Does the issue directly relate to the business or otherwise have a connection to the company? Does the issue have bearing on stated corporate values and interests? On CEO values and interests? Can the CEO and the company take a position that will be viewed as authentic?
- **Constituent interests and degree of controversy.** How controversial is the issue with key constituents? How likely is it that employees, customers, suppliers, regulators or the general public could react negatively (*e.g.*, through social media backlash, boycotts or changed legislative or regulatory positions or relations)? Is the issue of direct importance to employees? What are employees likely to think about the issue, and how are they likely to react? What positions have key institutional investors taken on the issue, and have they engaged with the company about it?
- **Financial impact.** What impact is taking a position on an issue expected to have on revenues, expenses and share value in both the near and longer term?
- **Risks of non-action.** What are the risks of staying silent on the issue to the company's business, reputation, relationships with employees, stockholders and the community, and/or share value?
- **Timing and form.** When will speaking out on the issue make the appropriate impact? Is this the right time? If speaking out is determined to be the right approach, what are the opportunities and risks in collective action (*e.g.*, seeking the support of like-minded chief executives) versus individual corporate action?

- **Peer activity.** Are peer companies or relevant trade associations taking a position on the issue?
- **Compliance.** What laws are relevant to taking a position, and what steps are required to comply with applicable laws (*e.g.*, laws relating to lobbying, campaign finance or government ethics)?
- **Board oversight.** Has the CEO's position on an issue been considered by the board or a board committee, and has a consensus emerged on next steps?

Oversight Responsibility

While boards are responsible under state law for the management and direction of the corporation, they usually delegate significant authority to the CEO to run the company on a day-to-day basis. This typically includes authority to serve as the corporation's spokesperson.

As with political spending and lobbying activities, the board's oversight responsibilities for corporate activity in the sphere of political and social speech are related to oversight of risk management, internal controls and ethics. While the board has discretion to determine management's degree of authority with respect to these issues, boards should consider what level of oversight they will provide and what policies and procedures will assist them in monitoring activity and providing guidance.

More Questions for Boards

The following questions are designed to help facilitate discussion about oversight of political contributions, lobbying activities and related policies.

- **Board expectations and oversight.** Has the board clearly defined its expectations about the company's approach to its political contributions and lobbying activities, as well as the board's role in oversight? Is board oversight supported appropriately through regular information flow? Do committee structures and charters support the company's approach?
- **Strategy.** What is the company's strategy with respect to political contributions and lobbying, and how does it relate to corporate strategy generally? What is the business case for this activity?
- **Risk management.** How does the company's strategy for these activities relate to risk management? What are the most significant issues and associated risks?
- **Values alignment.** How does management ensure that political contributions and lobbying activities align with the company's stated values?
- **Management responsibility.** Who is the senior executive with responsibility for managing these activities? How often does that manager report to the board or relevant board committee?
- **Internal controls.** How does responsibility and internal reporting for these activities relate to responsibility for risk management and compliance? Is the company appropriately positioned to assess and manage related risks?
- **Investor expectations.** How does the company's approach compare to the recommendations of key institutional investors?
- **Peer and industry comparison.** How do company practices measure up to peer and industry standards? Is the company leading, following or lagging industry and peer standards in the policies and procedures it has adopted, including with respect to disclosure? Is there a solid rationale for where the company is positioned, and is the company positioned where it wants to be?

JUDICIAL DEVELOPMENTS

Delaware Chancery Court Decision Analyzes Concepts of "Materiality" and MAE, Which Are "Analytically Distinct"

In December, the Delaware Chancery Court held that a buyer was not entitled to terminate a merger agreement because it did not adequately prove that the failure of certain representations to be true and accurate reasonably would be expected to have a "material adverse effect" (MAE) on the target. *Channel Medsystems, Inc. v. Boston Scientific Corp., et al.* (Del. Ch. Dec. 18, 2019). The Court also found that the buyer breached its obligation to use "commercially reasonable efforts" to consummate the merger.

In November 2017, Boston Scientific Corporation agreed to acquire Channel Medsystems, Inc. The closing of the merger was conditioned on Channel's one medical device under development—Cerene—receiving FDA approval by September 30, 2019. The next month, Channel discovered that its Vice President of Quality had engaged in fraud and other misconduct, including falsifying documents that were submitted to the FDA. Channel informed Boston Scientific and the FDA and kept them apprised as they investigated and took actions to remediate the effects of the misconduct over the next few months. In April 2018, the FDA accepted Channel's remediation plan, strongly suggesting that the misconduct would not impede FDA approval of the Cerene device. Weeks later, Boston Scientific sent a notice purportedly terminating the merger agreement, based on allegedly inaccurate representations made by Channel to Boston Scientific in the merger agreement. In September 2018, Channel commenced suit against Boston Scientific in the Delaware Chancery Court. In March 2019, the FDA approved the Cerene device, well in advance of the September 30 deadline.

Channel Medsystems, Inc. v. Boston Scientific Corp. adds to the growing Delaware case law on the "materiality" or "in all material respects" standard for purposes of assessing the accuracy of representations and warranties in M&A agreements.

The primary issue was whether Boston Scientific was entitled to terminate the merger agreement because of inaccuracies in several general representations, which contained materiality qualifications such as the terms "material" and "in all material respects." The merger agreement also contained an "accuracy of representations" closing condition (and a related termination provision) that allowed Boston Scientific to terminate the merger agreement for inaccuracies in Channel's representations *only if* those inaccuracies would have an MAE on Channel. Thus, to validly terminate the merger agreement, Boston Scientific would need to establish that (1) one or more of the specified representations was inaccurate and (2) the failure of those representations to be accurate would reasonably be expected to have an MAE on Channel.

When analyzing whether the specified materiality-qualified representations were inaccurate, the Court applied a "disclosure-based" standard of materiality endorsed in *Akorn, Inc. v. Fresenius Kabi AG* (Del. Ch. 2018). Under that standard, "[a] fact is generally thought to be 'material' if [there] is 'a substantial likelihood that the…fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available'" (quoting *TSC Indus. v. Northway, Inc.* (U.S. 1976)).

The Court next considered whether the inaccurate representations constituted or would have an MAE. Citing *Frontier Oil v. Holly Corp.* (Del. Ch. 2015), the Court noted "The 'concept of 'Material Adverse Effect' and 'material' are analytically distinct.'" Citing *Akorn*, the Court evaluated whether there was qualitative and quantitative evidence of a reasonably expected MAE based on the inaccurate representations. The Court concluded that "Boston Scientific had not proven that…the inaccurate representations would reasonably be expected to have a Material Adverse Effect" and that Boston Scientific had therefore not validly terminated the merger agreement.

The Court also found that Boston Scientific breached its covenant to use commercially reasonable efforts to consummate the merger. "Boston Scientific's 'utter failure to make any [meaningful] attempt to confer with [Channel] [regarding the independent assessment relating to the executive's fraud]…both constitutes a failure to use reasonable best efforts…and shows a lack of good faith.' The lack of good faith here is corroborated by contemporaneous evidence that Boston Scientific was looking for a way out of its deal with Channel due to growing concerns that Cerene would be difficult to market and that the proposed transaction was complicating a potential divestment of part of Boston Scientific's business."

In light of this decision, the "in all material respects" and "materiality" standards used within and applied to representations will be a "disclosure-based" standard that considers whether a reasonable acquirer would view the inaccuracy as significantly altering the total mix of information. However, the MAE standard is a different, higher standard. As with Akorn, this decision illustrates the importance of a party fully complying with its covenants to use "commercially reasonable efforts" to consummate a transaction up until the point the merger agreement is validly terminated, even if that party is considering termination.

Stockholders Are Not Required to Describe How They Plan to Use Corporate Books and Records Requested Under DGCL Section 220

Stockholders of a Delaware corporation may have an easier time obtaining its books and records based on a recent ruling in the Delaware Chancery Court. In *Lebanon County Employees' Ret. Fund, et al. v. AmerisourceBergen Corp.* (Del. Ch. Jan. 13, 2020), the Court clarified that, when presenting a demand to review the books and records of a Delaware corporation pursuant to Section 220 of the Delaware General Corporation Law (DGCL), a stockholder need only state a proper purpose and need not plead a possible line of argument in its demand.

Delaware Chancery Court in Lebanon County: "[A] stockholder need not both articulate a proper purpose for inspection and commit in advance to the ends to which it will put the books and records…Instead, the plaintiffs reserved the ability to consider all possible courses of action that their investigation might warrant pursuing."

Section 220 of the DGCL gives stockholders the right to inspect a corporation's books and records "for any proper purpose," meaning "a purpose reasonably related to such person's interest as a stockholder." Stockholders of a pharmaceutical wholesale company sought to review the company's books and records in light of numerous governmental investigations and multidistrict litigation the company faced in connection with its alleged involvement in the nation's opioid crisis. The Section 220 demand stated four purposes for inspection: (1) to investigate possible breaches of fiduciary duty, mismanagement and violations of law in connection with the company's distribution of opioids, (2) to consider any remedies to be sought relating to possible misconduct, (3) to evaluate the independence and disinterestedness of the company's directors and (4) to evaluate possible litigation or other corrective measures. The company rejected the demand, arguing that the stockholder plaintiffs did not "state a proper purpose or a credible basis to suspect wrongdoing" and that the scope of the demand was "overly broad." The stockholder plaintiffs filed an action in the Delaware Chancery Court to compel the company to produce the requested documents.

When seeking to obtain books and records, a stockholder must show, by a preponderance of the evidence, a credible basis from which the Court can infer possible mismanagement warranting further investigation. Under Delaware law, the "credible basis" standard is "the lowest possible burden of proof" and may be met "through documents, logic, testimony or otherwise, that there are legitimate issues of wrongdoing." The Court found that the "significant corporate trauma" suffered by the company due to ongoing investigations and litigation provided the stockholder plaintiffs with a sufficient evidentiary basis to suspect wrongdoing.

The company argued that if the stockholders wanted to use the books and records obtained to achieve an end other than filing litigation, they must have stated that in the demand. Vice Chancellor J. Travis Laster rejected this argument, holding that the demand was not required to articulate how they planned to use the requested books and records. He reiterated that Section 220 only requires that a stockholder state a proper purpose, not a "purpose-plus-an-end." A stockholder need not "commit in advance to what it will do with an investigation before seeing the results of the investigation."

The Court ordered the company to provide the stockholder plaintiffs with certain formal board materials, with an understanding that they may be entitled to additional books and records through a follow-on request after determining what books and records exist. The reduced standard endorsed by the Court in this case may prompt more stockholder plaintiffs to make Section 220 demands, especially at companies suffering significant trauma.

Delaware Supreme Court Upholds "Clear and Unambiguous" Deadline in an Advance Notice Bylaw

In January, the Delaware Supreme Court held that the Delaware Chancery Court erred by granting injunctive relief to Saba Capital Master Fund, Ltd. on its claim that two closed-end investment funds exceeded the authority permitted by their advance notice bylaws when requesting supplemental information about director candidates nominated by Saba. *BlackRock Credit Allocation Income Trust, et al. v. Saba Capital Master Fund, Ltd.* (Del. Jan. 13, 2020). Saba nominated four individuals for election to each of the funds' boards by the deadline provided in the funds' advance notice bylaws. Weeks later, the funds asked Saba to complete and return a 47-page questionnaire within five business days. Saba missed the deadline, and the funds declared the nominations invalid and disclosed in their proxy statements that votes for the dissident slate would not be counted at the upcoming annual meetings. Saba sued, seeking injunctive relief. As discussed in the Summer 2019 issue of *Sidley Perspectives*, the Chancery Court enjoined the funds from invalidating Saba's nominations and ordered that they count the votes in favor of the dissident slate at their annual meetings. The Chancery Court determined that the questionnaire was overbroad and not "necessary" or "reasonably requested" to determine whether Saba's nominees met the applicable director qualification requirements, and therefore Saba should be excused from complying with the deadline. The Delaware Supreme Court overturned that holding, finding that the Chancery Court erred in granting injunctive relief "in light of Saba's failure to timely respond."

Delaware Supreme Court: "[W]e are reluctant to hold that it is acceptable to simply let pass a clear and unambiguous deadline contained in an advance-notice bylaw, particularly one that had been adopted on a 'clear day.'"

Pursuant to the relevant bylaws, a stockholder who provided notice of a director nomination must provide "any subsequent information reasonably requested by the Board of Directors to determine that the Proposed Nominee has met the director qualifications as set out in Section 1 of Article II…no later than five (5) business days after the request by the Board of Directors." The Court held that although some of the questions sent did not relate to Section 1's director qualifications, Saba was not entitled to injunctive relief because it had missed the five-day deadline. The Court departed from the Chancery Court, finding that Saba, "as a sophisticated corporate entity," should have understood the meaning of the bylaws, and its failure to respond did not justify disregarding the deadline. Saba did not object to the breadth of the questionnaire until after the deadline had passed and did not strongly assert that position until long after the funds declared their nominations invalid. While the Court favors interpreting unclear bylaw provisions in favor of stockholder's electoral rights, the funds' bylaws were "clear and unambiguous." According to Justice Karen Valihura, an injunction would "frustrate the purpose of advance notice bylaws" by permitting participants to miss deadlines and then give after-the-fact excuses for their non-compliance. The Supreme Court's ruling provides some reassurance to companies that Delaware courts will respect the plain language of their advance notice bylaws.

Corporations Do Not Have a Right to Recover Excess Prepayments Under the Delaware Appraisal Statute

In 2016, Delaware amended its appraisal statute (Section 262 of the DGCL) to discourage appraisal arbitrage. The amendment permits corporations to limit the accrual of statutory interest on appraisal awards by prepaying appraisal claimants in any amount determined by the company at any time before judgment is entered in the appraisal proceeding. When a company makes such a prepayment, interest will accrue only on the amount by which the judicially determined appraisal award exceeds the amount that was prepaid rather than on the entire amount of the appraisal award. This amendment significantly reduces a company's exposure and eliminates much of the economic incentive of appraisal arbitrage, given that the current statutory interest rate is 5% over the Federal Reserve rate, compounded quarterly.

Because Section 262 of the DGCL does not explicitly contemplate any refund mechanism, appraisal claimants are entitled to keep the overpayment if a surviving corporation prepays them an amount that exceeds the appraised fair value.

In an issue of first impression, the Delaware Chancery Court recently ruled that a Delaware corporation was not entitled to a refund of excess amounts it had prepaid appraisal claimants when the Court determined that the fair value of the common stock was less than the deal price. In *re Appraisal of Panera Bread Co.* (Del. Ch. Jan. 31, 2020). Dissenting stockholders of Panera Bread Company challenged whether the $315.00 per share deal price JAB Holdings B.V. paid to acquire Panera in 2017 reflected fair value. The Court pegged the appraised fair value at $303.44, calculated as the deal price minus synergies.

Panera had prepaid the dissenting stockholders the full deal price of $315.00 per share. Panera sought a refund in the amount of the deducted synergies (*i.e.,* the difference between the fair value of $303.44 and the prepayment of $315.00), plus interest. The Court rejected Panera's request because Section 262 of the DGCL does not expressly contemplate any refund mechanism for overpaid amounts. In light of this decision, a Delaware corporation may wish to be conservative when determining the amount to prepay or try to negotiate clawback rights with dissenting stockholders that would entitle the corporation to a refund if the prepayment amount were to exceed a court's fair value determination.

CORPORATE GOVERNANCE DEVELOPMENTS

BlackRock and State Street Call for Sustainable Business Practices and Improved ESG Disclosure

Ahead of the 2020 proxy season, the chief executives of two of the world's largest institutional investors have issued a warning to boards of directors – make progress on ESG issues or be held accountable.

First, Larry Fink of BlackRock announced in his 2020 annual letters to CEOs and clients that BlackRock will "place sustainability at the center of [its] investment approach." While the letters emphasize climate-related issues, a set of concurrently released FAQs clarifies that sustainability is broader, encompassing environmental, social and governance (ESG) factors. Going forward, BlackRock will:

- Vote against board members and managers when companies have not made sufficient progress on sustainability and disclosing sustainability-related information in line with the standards promulgated by the Sustainability Accounting Standards Board (SASB) and the Task Force on Climate-related Financial Disclosures (TCFD);
- Launch new passive funds that screen fossil fuel companies and new actively-managed funds focused on advancing sustainability; and
- Remove from its actively-managed portfolios companies that generate more than 25% of their revenues from thermal coal production.

Mr. Fink sees BlackRock's shift in strategy not as a policy decision, but rather a business imperative. To him, "[c]limate risk is investment risk" and climate change "has become a defining factor in companies' long-term prospects." As a result, he believes that "sustainability- and climate-integrated portfolios can provide better risk-adjusted returns to investors."

Shortly after Mr. Fink published his letters, Cyrus Taraporevala of State Street Global Advisors (SSGA) published a letter to directors announcing SSGA will vote against directors of companies in the S&P 500 and certain other indices that lag behind their peers in "R-Factor" and do not articulate how they will improve. The R-Factor (the "R" stands for responsibility) is a scoring system developed by SSGA to measure the performance of a company as it relates to financially material and sector-specific ESG issues. The R-Factor endorses and draws upon SASB's disclosure framework. Like Mr. Fink, Mr. Taraporevala says "addressing material ESG issues is a good business practice and essential to a company's long-term financial performance—*a matter of value, not values.*"

As investors become increasingly focused on ESG issues, public companies should reassess their current ESG business and disclosure practices and determine whether changes are warranted. In doing so, they should consider the SASB or TCFD frameworks that have been endorsed by BlackRock, SSGA and several other institutions.

Some corporate leaders are also in favor of ESG disclosure that is more comprehensive and standardized. In January, a task force sponsored by the World Economic Forum's International Business Council released a draft ESG reporting framework titled Toward Common Metrics and Consistent Reporting of Sustainable Value Creation. Under the proposed framework, companies—regardless of geography or industry—would include in their SEC filings 22 ESG-related metrics and disclosures organized across four pillars: (1) Principles of Governance, (2) Planet, (3) People and (4) Prosperity. Many of the proposed metrics and disclosures were drawn from existing ESG reporting standards (e.g., the Global Reporting Initiative, SASB and TCFD).

New York State Will Require Corporations to Report on Board Gender Diversity

On December 30, 2019, New York Governor Andrew Cuomo signed into law a new board gender diversity reporting requirement for corporations authorized to do business in New York. Effective June 27, 2020, these corporations must report in their biennial filings with the Secretary of State how many directors sit on their boards and how many of those directors are women. The new law calls for the New York State Department of State and the Department of Taxation and Finance to conduct a Women on Corporate Boards Study to measure the number of women directors of corporations authorized to do business in New York. The first study will be published no later than February 1, 2022 and repeated every four years. It will report on (1) the number of women directors and the total number of directors on the board of each corporation, (2) the change in the number of women directors from previous years and (3) the aggregate percentage of women directors on all boards.

The New York law follows the enactment of a number of new state laws intended to correct the underrepresentation of women and minorities on corporate boards. Like the new laws in Illinois and Maryland, the law in New York is a reporting requirement only. It does not impose any substantive requirements regarding the composition of the board of any covered corporation. In that way, it differs markedly from the now-challenged California law requiring covered companies to maintain a certain number of women directors on their boards.

Companies are also facing pressure to diversify their boards from other sources. Goldman Sachs recently announced that, effective July 1, it will not take companies public in the U.S. and Europe if they do not have at least one diverse board member, which target will increase to two diverse directors beginning in 2021. Many key institutional investors and proxy advisory firms have also adopted policies in recent years that may trigger negative votes against directors at companies with no women directors. In light of these developments, companies should review their board composition and director nomination processes and consider whether any changes are warranted.

SEC Leaders Remind Audit Committees of Their Oversight Responsibilities

On December 30, 2019, SEC Chairman Jay Clayton, SEC Chief Accountant Sagar Teotia and Director of the SEC's Division of Corporation Finance Bill Hinman issued a joint statement on the role of audit committees and "key reminders" regarding their oversight responsibilities. The observations and guidance provided in the statement are intended to support "efficient and constructive dialogue among audit committees, management and independent auditors." The statement encourages audit committees to:

- Engage with management and the independent auditor as reporting and control issues arise.
- Proactively communicate with the independent auditor to understand the audit strategy and status.
- Consider periodically the sufficiency of the independent auditor's and the company's monitoring processes for compliance with the auditor independence rules.
- Engage proactively with management and the independent auditor with respect to implementing new GAAP standards.
- Understand identified ICFR issues and assist with resolving them.
- Understand and monitor management's remediation plans for any material weaknesses identified.
- Be mindful of PCAOB AS 1301, *Communications with Audit Committees*, which provides that the independent auditor should communicate to the audit committee matters related to certain accounting policies and practices, estimates and significant unusual transactions.
- Actively engage in the review and presentation of non-GAAP measures and metrics to understand (1) how management uses them to evaluate performance, (2) whether they are consistently prepared and presented from period to period and (3) the company's related policies and disclosure controls and procedures.
- Understand management's plan to identify and address the risks associated with reference rate reform (*e.g.*, the effect on accounting and financial reporting of contracts that reference LIBOR).
- Engage in a substantive dialogue with the independent auditor regarding the audit and expected critical audit matters (CAMs) to understand (1) the nature of each CAM, (2) the auditor's basis for the determination of each CAM and (3) how each CAM is expected to be described in the auditor's report.

The statement also encourages companies and independent auditors to keep these observations in mind when considering whether audit committees have adequate resources and support to fulfill their obligations.

SIDLEY RESOURCES

M&A Topics

Diagnosing and Treating Coronavirus Risks in M&A Transactions (Mar. 3, 2020). Novel coronavirus (COVID-19) continues to dominate headlines, and the virus outbreak has significantly affected global markets and local economies, forcing governments to take dramatic steps. The effects have significant consequences on businesses across industries. This Sidley Update seeks to help both buyers and sellers navigate and protect against risks introduced by the coronavirus outbreak in the context of M&A transactions.

FTC Targets M&A Agreements in Continued Campaign Against Noncompete and No-Poach Clauses (Feb. 21, 2020). In the span of five months, the U.S. Federal Trade Commission (FTC) brought two cases alleging that noncompete and no-poach clauses contained in merger agreements or other M&A agreements violated antitrust laws. Viewed along with recent changes to Hart-Scott-Rodino (HSR) Act reporting obligations, the FTC's recent challenges show that acquisition agreements have become increasingly fertile ground for antitrust authorities to focus their broader efforts against unreasonable noncompete, no-poach and similar agreements.

Corporate Governance Topics

The Corporate Purpose Debate. In an article published in the December 2019/January 2020 edition of Practical Law's The Governance Counselor, Holly J. Gregory, a partner in our New York office, discusses the recently reignited debate on the appropriate role of the corporation in society.

Proxy Access: A Five-Year Review (Jan. 16, 2020). Proxy access is now mainstream at S&P 500 companies (77%) and has been adopted by just over half of the companies in the Russell 1000. This Sidley Update provides a five-year review of proxy access in the U.S. as of the end of 2019. It includes an appendix that highlights the various terms of proxy access provisions adopted by 644 companies since the beginning of 2015.

SEC Topics

SEC Provides Conditional Filing Relief to Companies Affected by Coronavirus (Mar. 6, 2020). On March 4, the SEC announced the issuance of an Order providing conditional relief to public companies that are unable to timely comply with their filing obligations as a result of the novel coronavirus (COVID-19) outbreak. This Sidley Update summarizes the Order and corresponding announcement which provided reminders to public companies about their disclosure obligations in light of the COVID-19 outbreak.

Preparing Your 2019 Form 10-K: A Review of Recent Disclosure Developments, Priorities and Trends (Feb. 13, 2020). This Sidley Practice Note highlights key disclosure considerations for registrants as they prepare their 2019 Form 10-K filings. It discusses recent amendments to SEC disclosure rules and identifies significant disclosure trends and current areas of SEC staff focus.

SEC Provides Guidance on Disclosing Metrics in MD&A and Proposes Amendments to Financial Disclosure Requirements (Feb. 5, 2020). On January 30, the SEC issued interpretive guidance on disclosure of key performance indicators (KPIs) and other metrics in Management's Discussion & Analysis of Financial Condition and Results of Operations (MD&A), which companies should consider when preparing their 2019 Form 10-K filings. Concurrently, the SEC proposed amendments to modernize, streamline and enhance certain financial disclosure requirements in Regulation S-K. This Sidley Update summarizes the interpretive guidance, which took effect on February 25, and the most significant proposed amendments.

SEC Proposes to Modernize Auditor Independence Rules (Jan. 10, 2020). The SEC recently announced proposed amendments to Rule 2-01 of Regulation S-X intended to modernize its auditor independence rules, in part by codifying certain positions the SEC staff has taken in consultations over the years with respect to questions involving student loans and portfolio companies of funds.

Regulatory Topics

FTC Releases 2020 Thresholds for HSR Filings and Interlocking Directorates and Raises Maximum Per Diem HSR Penalty (Jan. 28, 2020). Effective February 27, the minimum "size-of-transaction" threshold for any acquisition of voting securities, non-corporate interests or assets not exempt from HSR notification requirements increased from $90 million to $94 million. Other thresholds related to HSR filings and to Clayton Act Section 8's prohibition against interlocking directorates also have increased. Additionally, the maximum per diem civil penalty amount for HSR violations is now $43,280.

Treasury Releases New CFIUS Regulations (Jan. 17, 2020). In January, the U.S. Department of the Treasury issued final and interim regulations implementing the Foreign Investment Risk Review Modernization Act of 2018 (FIRRMA), which expands the jurisdiction of the Committee on Foreign Investment in the United States (CFIUS) to review foreign investments and mitigate any potential national security concerns. The final CFIUS regulations went into effect on February 13.

SIDLEY EVENTS

Chicago General Counsel Roundtable

June 9 | Chicago, IL

Sidley's Chicago office will host its 13th Annual General Counsel Roundtable in Chicago on June 9. General counsel and chief legal officers interested in attending should e-mail chevents@sidley.com.

SIDLEY SPEAKERS

Antitrust Law Developments

April 22 | Washington, D.C.

The 68th Spring Meeting of the American Bar Association's Section of Antitrust Law will be held in Washington, D.C. on April 21-24. On April 22, Jim Lowe, a partner in our Washington, D.C. office, will chair a session titled Covenants, Conditions & Commas, Oh My! and Amanda Norton, an associate in our Washington, D.C. office, will chair a session titled Common Minority Interests: Major or Minor Problem? Click here for more information.

Conversation with U.S. Attorney for the Northern District of Illinois

April 23 | Chicago, IL

John Kelsh, a partner in our Chicago office, will moderate a conversation with John R. Lausch Jr., the U.S. Attorney for the Northern District of Illinois, at the 40th Annual Ray Garrett Jr. Corporate & Securities Law Institute at Northwestern Pritzker School of Law in Chicago on April 23. Click here for more information.

Future of Corporate Law: 2020 and Beyond

May 14 | New York, NY

Holly J. Gregory, a partner in our New York office, will participate in a panel discussion titled *Future of Corporate Law: 2020 and Beyond* at the Practising Law Institute's Delaware Law Developments 2020: What All Business Lawyers Need to Know program in New York on May 14. Click here for more information.

ACC General Counsel Roundtable

May 28 | Silicon Valley, CA

Ms. Gregory will participate in a general counsel roundtable panel discussion at the Association of Corporate Counsel's Corporate Counsel Institute in Silicon Valley on May 28. Click here for more information.