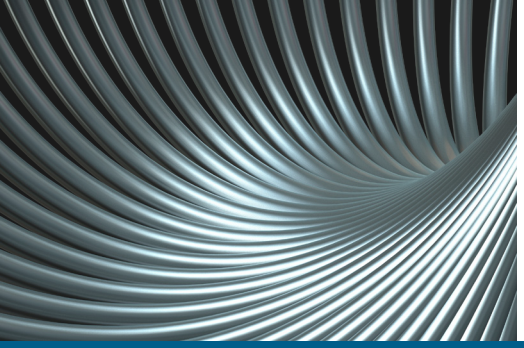

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ANALYSIS

BACK TO THE FUTURE: NEW LINES DRAWN FOR POISON PILLS

By Charlotte K. Newell, Beth Berg, Kai Liekefett and Derek Zaba[1]

In a tale of what is old is new again, the Delaware Court of Chancery reviewed the propriety of a poison pill – a bulwark of the 1980s takeover era – but in the context of shareholder activism against the backdrop of the COVID-19 pandemic. Vice Chancellor Kathaleen McCormick's detailed review of the pertinent case law and fact-specific decision to permanently enjoin The Williams Companies, Inc.'s extraordinary 5% poison pill offers a number of lessons for directors considering the adoption or renewal of a similar device. *The Williams Cos. S'holder Litig.* (Del. Ch. Feb. 26, 2021).

The Delaware Court of Chancery: "The Williams pill is unprecedented in that it contains a more extreme combination of features than any pill previously evaluated by this court – a 5% trigger threshold, an expansive definition of "acting in concert," and a narrow definition of "passive investor."

In March 2020, as the COVID-19 pandemic was tightening its grip on the United States, the company implemented a stockholder rights plan, or poison pill, with what the Court called an "extreme, unprecedented collection of features":

- a 5% trigger;
- a definition of "acquiring persons" that captured derivative interests like warrants and options;
- an "acting in concert," or "wolfpack," provision that expanded the plan's trigger further to aggregate the parallel activities of stockholders; and
- an unusually limited "passive investor" exemption.

The company's board of directors adopted the plan after two meetings in mid-March 2020 (having had a rights plan "on the shelf" and being last briefed on the plan in October 2019), but litigation revealed that most directors had not considered the plan's features other than the 5% trigger and did not receive a draft of the plan before deciding to adopt it. Although poison pills were originally developed as a tool to help a board address a known threat of a takeover or rapid accumulation of shares, the Williams board acted preemptively (*i.e.*, in the absence of a particular threat). The board was concerned that the company's stock price decline due to the pandemic and oil price volatility might encourage shareholder activism or other attempts to opportunistically purchase substantial influence or even control.

While the Court noted that the board's process was "less than perfect," it was not the process that led the Court to enjoin the pill. To the contrary, the Court found that the board was composed largely of independent, outside directors who conducted a good faith and reasonable investigation under the circumstances. Rather, the Court determined that the pill's terms and the circumstances in which it was deployed fell short of the board's obligations under the *Unocal* line of cases. *Unocal* is a situationally-specific form of enhanced scrutiny, that requires a board to satisfy a two-prong test to defend the propriety of a defensive measure. First, the board must show it had reasonable grounds "to conclude a threat to the corporate enterprise existed." Second, the board must show that the defensive measure was "reasonable in relation to the threat posed."

It is noteworthy that the Court applied the *Unocal* level of scrutiny to the *adoption* of the pill, rather than a decision of the board not to dismantle or redeem the pill, noting the entrenchment effect of any pill by its nature. Although it is true that since *Moran v. Household International, Inc.*, Delaware courts have subjected stockholder challenges to pills to intermediate scrutiny under *Unocal*, the Williams pill was adopted on a "clear day" and not in response to a specific activist or hostile takeover threat.

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1 Charlotte K. Newell is an associate in Sidley's New York office whose practice focuses on stockholder class and derivative actions, M&A litigation, securities class actions and investment fund matters. Beth Berg is a partner in Sidley's Chicago office with an active practice advising public companies and boards of directors on M&A, shareholder activism, corporate governance and SEC disclosure matters. Kai Liekefett in Sidley's New York office and Derek Zaba in Sidley's Palo Alto office are the co-chairs of Sidley's Shareholder Activism practice. Since 2016, they have defended against more than 70 proxy contests and represented issuers in more than 30 settlements, more than any other defense law firm. The views expressed in this article are those of the authors and do not necessarily reflect the views of the firm, its other lawyers or its clients.

The Court concluded for purposes of the first *Unocal* prong that the board was not acting in response to any specific threat but rather was acting "pre-emptively to interdict hypothetical future threats." The evidence suggested the board's concerns encompassed a desire to prevent activism while the company's stock price was depressed; the parallel threat of short-termism prevailing or distracting management; and finally that the pill would act as an early warning device if any stockholder acquired 5% or more of the company's stock. None of these passed muster; the first two were rejected because they were purely speculative and not cognizable threats. As for the third, the Court assumed for purposes of its analysis (but did not hold) that a pill could provide a company with early warning of an accumulation of stock. Here the parties focused on a hypothetical "lightning strike" attack, in which an insurgent rapidly and stealthily continues to accumulate a large stake after crossing the 5% threshold for Schedule 13D filings but no public disclosure is made until the 10-day deadline under the applicable federal securities laws.

In turning to the second *Unocal* prong, the Court found that the pill was not reasonable in relation to the assumed threat (the "lightning strike"). For starters, the Court held that a 5% trigger for a "regular" poison pill (*i.e.,* excluding tax NOL pills) was practically without precedent. The sole other company to adopt such a plan did so "in the face of a campaign launched by an activist who owned 7% of the company's outstanding shares." Each of the other 20 plans adopted in the three weeks following the company's had a higher threshold. And the Court went on to note that the plan's other features exceeded what would be necessary to foreclose the lightning-strike attack.

The Delaware Court of Chancery invalidated the Williams poison pill holding that the directors "failed to show that this extreme, unprecedented collection of features bears a reasonable relationship to their stated corporate objective" of responding to a legitimate threat.

Another problematic term in this regard was the Williams pill's aggregation of the holdings of stockholders "acting in concert" without an express agreement. Vice Chancellor McCormick was highly critical of the company's wolfpack provision, characterizing it as the "primary offender" and "the most problematic aspect of the Plan" (more so than the 5% trigger). The wolfpack provision in the Williams rights plan applied to persons acting in concert or in parallel or towards a common goal "relating to changing or influencing the control of the Company" where "at least one additional factor supports a determination by the Board that such Persons intended to act in concert or in parallel, which additional factors may include exchanging information, attending meetings, conducting discussions, or making or soliciting invitations to act in concert or in parallel," with certain exceptions. This broad definition of "acting in concert" exceeds reporting requirements pursuant to the federal securities laws (which require an agreement). It was then coupled with a "daisy chain" clause, which further expanded the provision's reach by aggregating stockholders even if they were unknown to each other. The Court took issue with the provision's language, arguing that the board could misuse its power and trigger the rights plan in response to routine and innocuous stockholder communications and activities (*e.g.,* attending the same investor conferences or advocating for the same shareholder proposals or corporate actions). The Court also took issue with how the Williams pill attempted to restrict stockholder communications and nominate directors. *Williams* suggests that Delaware courts will scrutinize carefully wolfpack provisions that potentially discourage legitimate interaction among stockholders. If a company's board determines that a wolfpack provision is necessary and proportionate in response to a threat the company faces, it should be sure that the provision is drafted clearly and narrowly to minimize litigation risk.

The *Williams* decision should not wholesale deter boards from deploying a poison pill with features that are reasonable and proportionate in response to a cognizable threat. However, directors considering a poison pill should be mindful of and discuss at least the following with their counsel:

- ensuring adequate deliberation and discussion of the plan and its specific features prior to approval – preferably, over multiple meetings and with the benefit of review of all pertinent documents;
- memorializing the specific, non-hypothetical threat(s) to which the board is reacting;

- considering how the plan's features, including its trigger threshold, compare with judicial precedents and market practice; and
- discussing how the plan and each of its features is tailored to the identified threat(s) to build the record for any subsequent judicial review pursuant to *Unocal*.

Additional, more general, takeaways from the *Williams* decision include:

- another reminder not to include in board agendas allotted periods of time for specific items – the Court specifically called out how much time the agenda provided for specific items and even compared the fact that one agenda assigned 40 minutes to the rights plan and 20 minutes to the discussion of whether to hold the annual meeting virtually;
- that it is better to err on the side of sending the board too many materials than too few materials – it is important that directors receive copies of the agreements they are being asked to approve and, where appropriate, summaries of the key terms of those agreements; the *Williams* opinion notes that the Williams board did not receive a copy of the rights plan before the board approved it and that most of the directors admitted that they had not read the plan's key features until after the litigation began;
- that it may not be ideal for management to take the lead presenting to the board on highly specialized topics like rights plans – while the Court did not specifically criticize this, it did note that "aspects of the process were less than perfect" and that the CEO and GC delivered the rights plan presentation (although outside counsel and financial advisors were in attendance); notably, while the decision quotes the financial advisor, it does not mention that representatives of outside counsel *even spoke* during the meeting; and
- another reminder to exercise caution in emails and notes – the Court cites emails between the company and its counsel regarding the activism threat in advance of the pill adoption, and the opinion quotes the CFO's notes.

"AN OUNCE OF PREVENTION IS WORTH A POUND OF CURE": EFFECTIVE PRACTICES FOR BOARD MINUTES AND RELATED BOARD MATERIALS

By Charlotte K. Newell and Holly J. Gregory[2]

The above-referenced turn of phrase was penned by Benjamin Franklin in admonishing his fellow Philadelphians to take heed of fire prevention strategies. Although the benefits discussed here are short of life-saving, attention to implementation and periodic review of your practices for the preparation and maintenance of board minutes and related materials can yield significant dividends in managing and mitigating litigation risk, including the risk of personal liability for directors. In addition to providing an accurate record of board decisions, to the extent that minutes evidence directors' good faith, diligence, and absence of conflict (or appropriate handling of conflict), minutes can help support early termination of stockholder suits for breach of duty. Attention to board (and board committee) minutes is especially important given the increase in demands by would-be stockholder plaintiffs for corporate books and records to assist them in assessing potential claims and constructing their allegations.

There is no one road map to properly taking minutes and maintaining books and records. It is worth a short conversation with counsel to discuss how to best implement books and records processes at your organization, and to periodically review and assess those processes. Topics to consider include:

2 Charlotte K. Newell is an associate in Sidley's New York office. Holly J. Gregory is a partner in Sidley's New York office and a co-leader of the firm's global Corporate Governance and Executive Compensation practice. This article has been excerpted from a recent post in Sidley's Enhanced Scrutiny blog. The views expressed in this article are those of the authors and do not necessarily reflect the views of the firm, its other lawyers or its clients.

Pre-Meeting Objectives: Timely Circulation of Materials

Directors rely on management and expert advisors for the information necessary for determining board actions. Directors are typically sent an agenda and presentation materials for their review before a board meeting. "Board books" often provide an update regarding events since the last meeting, the prior meeting's minutes for approval, and an agenda of, and the detail relating to, the topics to be discussed and determined at the upcoming meeting.

Board materials are often voluminous – possibly several hundred pages of presentation decks and supporting materials. Generally, the majority of board materials should be circulated a week or so before a meeting to allow directors adequate time to consider the information provided.

Pre-Meeting Objectives: Director Obligations and Communications

The materials and presentations provided to the board and its committees should be thorough, timely, and relevant, and a record of these materials should be maintained and referred to in the minutes to help provide a record of the informed nature of board and committee deliberations and decisions.

Directors are expected to review the materials provided to fulfill their fiduciary duty of care and be prepared to engage in meaningful discussion about potential actions and forward-looking strategy in board and committee meetings. The goal is informed sharing of perspectives, identification of additional information that is appropriate, and discussion of the options and risks of proposed actions with fellow directors, management, and advisors.

While many directors use email to facilitate logistics (*e.g.*, calendar invitations), all should be cautious about email use for substantive discussions. The same holds for other informal communications, including text messages. Such communications should not be handled using private email or phone accounts. Company-specific email accounts or a board portal are a better means of ensuring the confidentiality and privilege of the corporate materials being shared. But these informal communications should be avoided for other reasons too: most importantly, that one-off communications are not a replacement for board-level deliberation and can be easily taken out of context. Such informal messages are often subject to discovery in litigation and, thus, any such messages must be written with the proverbial "New York Times rule" in mind: Assume your email or text messages could be a headline one day.

The same considerations apply to director note-taking. The corporate secretary will memorialize the meeting, and directors should not take notes for that purpose. Such notes, if necessary, should only be made to facilitate a director's review of the board deck or asking of questions during the meeting.

Meeting Minutes Process Pointers: Accuracy and Timeliness Matter

The corporate secretary usually takes notes at the board or committee meeting, and often prepares, prior to the meeting, an outline of the items for discussion and deliberation, and potential resolutions, to assist in that process. Board minutes generally follow the order of the agenda and include information about the timing of the meeting and those in attendance. Consideration should be given before the meeting to any areas likely to involve privileged materials or discussions.

Because memories fade with time, minutes should be prepared and circulated to those who attended promptly, with an invitation to review and provide any comments. (Ideally, draft minutes should be circulated within a week or so of the meeting.) Typically, the revised draft minutes then circulate again to the board or committee members for approval at the next meeting.

While it can be difficult to circulate and review minutes when circumstances like a crisis require frequent meetings, having a tight process and time frame in place in the ordinary course will help to maintain timeliness in hectic times. A failure to timely prepare minutes may lead to questions regarding their accuracy.

Meeting Minutes Process Pointers: Striking the Right Balance

Board minutes must reflect board action and should evidence the good faith, diligence, and lack of conflict underpinning the action. They should include information sufficient to evidence that directors were well-informed both in terms of substance and process and acted as fiduciaries.

Drafting board minutes is an art, not a science. But several high-level guidelines should be kept in mind:

- Minutes should track the board or committee meeting agenda and, in areas where there is no decision called for, consideration should be given to providing evidence that the board or committee was faithfully exercising its oversight responsibilities. This is especially important in the areas of legal and regulatory compliance and risk management.
- Minutes should include by reference the complete universe of information on which the board relied (*e.g.*, board books, management presentations, and/or expert advice).
- Minutes should reflect the reason or rationale for critical decisions, and the range of factors the board considered in reaching those decisions. If not provided in the minutes (or included through reference to board materials, presentations, and/or expert advice), it will be more difficult to later prove the breadth of the board's considerations.
- Minutes should clearly state the board's final decision(s). Resolutions are often used to help describe the rationale and context for decisions (in "Whereas" clauses) as well as the specific parameters of the decision and related instructions to management or others on implementation. It is helpful to have resolutions drafted in advance for the board to consider for major actions, with the final resolution amended as required in the boardroom to track the final outcome.
- Because minutes and related materials may be later subject to production, it is advisable to segregate privileged information from the remainder of the minutes. This can be as simple as ensuring that information received from, or discussions with, counsel are in their own discrete paragraphs marked privileged, with references to the involvement of counsel, that may be redacted later on.
- If a segment of the meeting is held in "executive session" – a term used to describe a portion of the meeting held without members of management present – care should be taken to note who is in attendance and the general topics that are discussed. Often the director who leads this session will take very short notes and provide them to the corporate secretary. These sessions typically are not for the purpose of taking action but are designed to allow the non-management and independent directors to share perspectives on management's performance and identify areas for further inquiry and feedback to management.
- While it is important that minutes provide an accurate and complete description of the board's activity, minutes should not be a transcript. Often, minutes do not identify individual directors as speakers or include direct quotes or specific questions asked. Minutes should tell the complete story of a meeting, absent gloss or the writer's personal perspective.

How Meeting Minutes May Impact Subsequent Litigation

Well- or poorly-drafted minutes can play varied roles in later litigation. For example, in so-called *Caremark* claims, directors are accused of failing to properly oversee the company by either (1) failing to implement a corporate reporting system or (2) creating such a system but consciously failing to monitor or act on it. Plaintiffs are thus often trying to prove a negative – that a board did not discuss a particular topic or issue. Board minutes are the best proof of the information directors considered (including information incorporated by reference) and their deliberation and consideration of the issues. Well-drafted minutes can

thus play an important defensive role because they can evidence directors' deliberations on challenged topics.

Post-Meeting: Ensure Proper Maintenance of Records

Having taken the time to prepare board decks and minutes of meetings, it is critical to ensure they are properly maintained. Each company maintains its books and records differently and should ensure that it does so in accordance with its record-keeping policies and IT protocols to ensure safekeeping and continuity. All board decks and any other materials that are referenced in board minutes should be maintained with finalized minutes. Such supporting materials reflect the information the board considered and provide important context for understanding the minutes and resulting board action.

Taking a few moments today to review and assess whether your record keeping practices are appropriate could save significant time and energy down the road.

JUDICIAL DEVELOPMENTS[3]

Delaware Court of Chancery Orders Company to Wave Goodbye to Privilege After Seconded Employees Use Other Company Email to Discuss Non-Company Business

The Delaware Court of Chancery decision in *In re WeWork Litigation*, issued on December 22, 2020, underscores the need for heightened care with respect to corporate communications and the preservation of the attorney-client privilege.

In late 2019, Softbank Group Corp. agreed to use reasonable best efforts to effectuate a tender offer of up to $3 billion of The We Company (WeWork) stock. The tender, although commenced, was never consummated. Shareholder litigation followed. At the time of the failed tender, Softbank owned a majority stake in Sprint, Inc., and a number of Softbank employees were "seconded" to Sprint. Importantly, Sprint had no role in the tender offer. However, Softbank employees had access to Sprint email accounts and used those accounts for privileged communications with Softbank counsel regarding the tender offer. The plaintiffs in the *WeWork* shareholder litigation sought to compel production of documents in the Sprint email accounts, on the ground that any privilege had been waived.

In addressing the waiver issue, the Court of Chancery relied predominantly on the four-factor test articulated in *In re Asia Global Crossing, Ltd.*, 322 B.R. 247 (Bankr. S.D.N.Y. 2005) used to determine reasonable expectations of privacy with respect to work-related email communications. The *Asia Global* factors are as follows: (1) Does the corporation maintain a policy banning personal or other objectionable use, (2) does the company monitor the use of the employee's computer or email, (3) do third parties have a right of access to the computer or emails and (4) did the corporation notify the employee, or was the employee aware, of the use and monitoring policies?

Here, Sprint's code of conduct contained express admonitions with respect to an employee's expectation of privacy in information relayed using Sprint email. And although the record was devoid of evidence of Sprint's email monitoring practices, the Court noted that the code of conduct expressly reserved Sprint's right to do so. Accordingly, the Court concluded the first and second *Asia Global* factors were easily met.

The Court also found the third *Asia Global* factor to weigh in favor of production because Softbank failed to provide "compelling evidence" that its seconded employees took "significant and meaningful steps to defeat" Sprint's access to their communications, "such as shifting to a webmail account or encrypting their communications." Finally, with respect to the fourth factor, the Court concluded the seconded employees were aware of Sprint's

3 The following Sidley lawyers contributed to the research and writing of the pieces in this section: Elizabeth Y. Austin, Lora Chowdhury, Jim Ducayet, Claire H. Holland, Vincent J. Margiotta, Emily P. Morgan, Charlotte K. Newell, Andrew W. Stern and Robert Velevis.

email policies and "thus could not have had a reasonable expectation of privacy when they used their Sprint email accounts" to communicate about the business affairs of Softbank.

Although *WeWork* involved employees who worked across companies with overlapping ownership, the decision provides an occasion for reminding employees/partners of venture capital and private equity firms, as well as outside corporate directors, of the risks of using email from their "day job" for purposes of another entity. Here, the issue arose for employees of Softbank who were seconded to Sprint and using Sprint email. Outside corporate directors sometimes use their email from their primary employer rather than their personal email or an email account with the company on whose board they sit. Most companies, as Sprint here did, have policies on the use of email and other communications transmitted across their networks. And those companies monitor or, at minimum, reserve the right to monitor, such communications. Moreover, it is standard corporate practice for companies to inform their employees of such policies and procedures, whether through codes of conduct or employee handbooks, and for employees to acknowledge the same. Thus, passing the *Asia Global* test will often not be hard.

In situations where a fund partner or employee serves in a board or management role for a portfolio company, it is prudent to have clear policies and frequent reminders to use the correct email for the separate companies. For corporate directors, the use of their primary work email for another company's board business may be a harder habit to kick but also worth addressing. In our experience, it is not unusual to see outside directors occasionally send emails to outside or company counsel, to management, or other directors from their "primary work accounts." As a general matter, of course, the use of email, texting or other electronic communications among board members, whether for purposes of obtaining legal advice or for communication among themselves, presents its own risks. Board business should, to the extent possible, occur in formal meetings called with appropriate notice and memorialized in board minutes that reflect what was discussed. *WeWork* adds another layer of risk and suggests such communications present the additional possibility of a privilege waiver. To guard against that risk, to the extent that electronic communications are necessary, the consistent use of board portals – rather than standard email platforms – is a prudent step to avoid waiver concerns. Another step would be to adopt policies requiring outside directors to use personal email addresses, such as Gmail accounts, for any board business, or to provide an email address at the company for each director. As a practical matter, it can be helpful (and less intrusive in the event of litigation) if an outside director sets up a dedicated board-specific personal email address and then consistently uses that account, rather than a general personal email account, for board business. And it is often easier for all involved if a director's email is on the company's server and thus available to collect and search in the same manner as employees.

One final note: Depending on the circumstances, the potential consequences of waiver may be quite serious. If the communications are protected *attorney work product*, it may be possible in many jurisdictions to limit the scope of the waiver to the actual documents at issue. However, if the claim is based only on the *attorney-client privilege*, the waiver of privilege may operate as a general subject-matter waiver on *all* related privileged communications on the same topic, not simply those made with another company's email system. For this reason, meaningful corporate oversight and guidance on these issues is even more important.

Delaware Court of Chancery Will Evaluate Third-Party Sales of Controlled Companies Under the Enhanced Scrutiny Standard of Review

The Delaware Court of Chancery recently held that a stockholder plaintiff pleaded facts sufficient to support a reasonable inference that a target company's board of directors could have achieved a higher deal price had the company's financial advisor not, unbeknownst to the board, tipped the buyer about the price of another bid during the sale process.

Firefighters' Pension System of the City of Kansas City, Missouri Trust v. Presidio, Inc. (Del. Ch. Jan. 29, 2021). In the *Presidio* opinion, Vice Chancellor J. Travis Laster confirmed that the intermediate enhanced scrutiny standard of review – as articulated in the Delaware Supreme Court's 1986 *Revlon* decision – will apply to future sales of controlled companies to third parties.

In December 2019, Presidio, Inc. (the company) merged with an affiliate of London-based private equity firm BC Partners Advisors L.P. (BCP). The company's stockholders, including a controlling stockholder that controlled 42% of the voting power and was entitled to appoint five of the company's nine directors, received $16.60 per share in cash.

The sale process began in May 2019, when the company's controlling stockholder and its financial advisor met with each of BCP and private equity firm Clayton Dubilier & Rice, LLC (CD&R) in connection with exploring a potential sale of the company. In July 2019, BCP offered to acquire the company for $15.60 per share. The company's board countered with a price of $16.25 per share plus a robust go-shop provision. BCP increased its offer to $16.00 per share and agreed to the go-shop, which was memorialized in a merger agreement entered into on August 14, 2019. The $16.00 deal price valued the company at $2.1 billion and represented a roughly 20% premium over the company's trading price.

The go-shop began immediately and the company's financial advisor contacted 52 potential buyers, including CD&R. On September 23, 2019, CD&R offered to acquire the company for $16.50 per share, although indicating that its offer price "could potentially increase" after completing additional confirmatory diligence. Under the merger agreement with BCP, the company's CEO would roll over two-thirds of his equity and run the company post-closing; CD&R's offer, in contrast, did not contemplate an equity roll-over or post-merger employment for the CEO.

CD&R qualified as an "Excluded Party" under the company's original merger agreement with BCP, meaning the company (1) could continue to negotiate with CD&R for 10 days and (2) would be subject to a lower break-up fee of $18 million if it terminated the merger agreement for a deal with CD&R (rather than $40 million for non-Excluded Parties). Unbeknownst to the company's board, the company's financial advisor allegedly informed BCP about the specific price of CD&R's bid. Based on this tip, BCP immediately raised its offer to $16.60 per share conditioned on a flat termination fee of $40 million applying to a deal with any competing bidder (whether or not it qualifies as an Excluded Party). BCP insisted that the company respond to its increased offer within 24 hours. The company's board instructed the financial advisor to ask CD&R to increase its offer and push for a response in less than 24 hours (eight days sooner than CD&R's deadline to negotiate under the merger agreement). CD&R met the deadline and responded that it could raise its bid to at least $17.00 per share but noted that it would likely exit the sale process if the company increased the termination fee. Having concerns about CD&R's offer, and still unaware of the financial advisor's tip to BCP, the board accepted BCP's offer and entered into a revised merger agreement. The company publicly announced the revised merger agreement and CD&R did, in fact, walk away from the process, foreclosing a bidding war. The company's stockholders approved the merger by more than 85% of the vote and the deal closed on December 19, 2019. Thereafter, a former stockholder sued, arguing that (1) the CEO, board, and controller breached their fiduciary duties by approving the amended merger agreement and failing to disclose all material information to stockholders and (2) the company's financial adviser and BCP aided and abetted those breaches. The complaint alleged that the company's CEO, controlling stockholder, and financial advisor tilted the sale process in BCP's favor out of self-interest: the CEO due to the promise of post-closing compensation and employment; the controlling stockholder because it was eager to unload its investment in the company quickly; and the financial advisor to further its lucrative relationships with BCP, the controlling stockholder and the CEO.

The defendants moved to dismiss, arguing that in the absence of a *conflicted* controlling stockholder the business judgment rule applied. For this, the defendants pointed to *Corwin v. KKR Fin. Holdings LLC* (Del. 2015) and argued that the merger was approved by a fully informed, uncoerced majority of the disinterested stockholders. The Court found that *Corwin* cleansing was not available to lower the standard of review because, among other things, the merger proxy statement failed to disclose the financial advisor's tip to BCP which rendered the stockholder vote not fully informed.

The Court also considered arguments regarding the impact of the controller's alleged conflict of interest, and the resulting impact on the standard of review. The plaintiff argued that the controlling stockholder "faced a liquidity-driven conflict" because it (1) held its investment in the company for twice as long as planned, (2) demonstrated its desire for liquidity by selling more than 21,000,000 shares in four secondary offerings, (3) would be able to appoint only four – rather than five – directors at the company's next annual meeting and (4) acted in accordance with its desire to liquidate by swiftly accepting BCP's revised offer rather than allowing a bidding war with CD&R to unfold. In response, the defendants pointed to the Delaware Court of Chancery's decision in *In Re Synthes, Inc. S'holder Litig.* (Del. Ch. 2012), where the Court found that a desire for liquidity could rise to the level of a disabling conflict of interest only in the context of a "crisis" or "fire sale" where the controller agrees to a sale to satisfy an "exigent need" for immediate cash. Thus, the *Synthes* court determined that the controller was not conflicted when the company engaged in a merger in which all of the company's stockholders received the same consideration and applied business judgment review to the merger. *Synthes*, however, represented a departure from the Delaware Supreme Court's 2000 decision in *McMullin v. Beran*, where the Supreme Court applied enhanced scrutiny to a controlling stockholder's decision to sell a controlled subsidiary even though the controlling stockholder received the same consideration as all other stockholders. The *McMullin* court reasoned that the duty to maximize stockholder value pursuant to *Revlon* was "implicated" in the context of evaluating a proposal for the sale of a company to a third party at the behest of the controlling stockholder.

In *Presidio*, Vice Chancellor Laster followed *McMullin*, reasoning that the same standard of review should apply to the actions of a controlling stockholder as would apply to a board when either undertakes a sale of the company. He also rejected the argument that *Synthes* conflicted with *Corwin* in that *Synthes* would allow business judgment deference without the critical step of approval of the transaction by a fully informed, uncoerced stockholder vote. Finally, Vice Chancellor Laster explained that enhanced scrutiny review would enable a plaintiff to challenge – and a court to review – situations where a sale process is tainted by self-interest, as was reasonably conceivable in this case.

The Court evaluated the Presidio merger under the enhanced scrutiny standard of review and held that the complaint's allegations supported a reasonable inference that the sale process fell outside the range of reasonableness. This was primarily due to the financial advisor's undisclosed tip to BCP which the Court characterized as "cast[ing] a dim light on the sale process." Specifically, the Court found it reasonably conceivable at the pleading stage that (1) the financial advisor and CEO tilted the sale process in BCP's favor based on self-interest and (2) the board failed to provide active and direct oversight of the financial advisor, including by not requiring disclosure of or investigating actual or potential conflicts of interest until after the merger agreement was signed. The dismissal was granted in part, however, to parties that were exculpated from liability under the Company's charter (*i.e.*, directors, other than the CEO against whom a cognizable duty of loyalty claim had been pled) and the controller (as to whom the complaint failed to allege gross negligence). The remainder of the case and the aiding and abetting claims will thus continue. *Presidio* is a must-read for those interested in the standard of review applicable to corporate mergers, and is a reminder that the appearance or existence of undisclosed conflicts of interest are substantial fodder for stockholder plaintiffs.

Caremark Claims: Not Mission Impossible, but Still Risky Business for Plaintiffs

The Court of Chancery provided its latest guidance on so-called *Caremark* claims in a New Year's Eve opinion issued by Vice Chancellor Sam Glasscock in *Richardson v. Clark*, an action brought derivatively by a stockholder of MoneyGram International, Inc. The opinion dismissing the claims, in which the Court had some fun with film titles from Tom Cruise's career, provides an important level-setting because some have questioned whether Delaware's courts are lowering the bar for claims alleging that a board of directors failed in its oversight duties. *Richardson* should provide some comfort to directors that the standards have not changed: Absent particularized allegations of bad-faith action (or inaction) by a board, such claims should not survive a motion to dismiss.

Richardson *should provide some comfort to directors that the standards for bringing* Caremark *claims have not changed: Absent particularized allegations of bad-faith action (or inaction) by a board, such claims should not survive a motion to dismiss.*

MoneyGram facilitates the transfer of funds among businesses and individuals worldwide. Inherent in such a business is a risk that criminals will use its platform and services to aid fraud and money laundering activities. Not surprisingly, MoneyGram is subject to extensive government regulation and is required to maintain rigorous internal controls and compliance systems. Noncompliance with applicable law and regulations could lead to serious consequences, including suspension or even termination of the company's business. Consequently, noncompliance "presents a significant risk to MoneyGram's business model."

Notwithstanding this substantial risk, the company has found itself subject to several governmental actions alleging various failures in systems and controls. These actions culminated in 2012 with a deferred prosecution agreement (DPA) pursuant to which the company agreed to (1) pay $120 million into a fund for victims of fraud enabled by the company's services and (2) substantially improve the company's compliance systems and controls over five years. The plaintiff alleged that notwithstanding the DPA, complaints of fraudulent and illegal activities did not decrease and the company was unable to meet the requirements of the DPA. The company thereafter was compelled to pay an additional $125 million into the victims' restitution fund and extend the DPA for an additional four years.

The plaintiff brought claims against the company's directors and two of its officers, alleging that they had failed "to exercise oversight sufficient to comply with their fiduciary duties." Specifically, the plaintiff claimed that the defendants had failed the second prong articulated by the Delaware Supreme Court in its landmark *Caremark* decision: that the defendants *had* in fact established compliance systems but, "having implemented such a system or controls, consciously failed to monitor or oversee operations thus disabling themselves from being informed of risks or problems requiring their attention."

Because MoneyGram's certificate of incorporation includes a Section 102(b)(7) provision that exculpates directors from liability other than for breaches of the duty of loyalty, to proceed, the plaintiff would have to plead with particularity that the defendants had acted in bad faith which the Court equated with acting with *scienter* (*i.e.*, knowingly).

The Court concluded that the plaintiff failed to meet this exacting standard. Addressing what the plaintiff had alleged were "red flags" regarding the company's compliance systems, the Court noted that the company had in fact taken numerous actions to improve its anti-fraud and anti-money laundering controls, and there had been some improvement – just not enough. As the Court put it:

> The DPA left it up to the company to devise methods to prevent agent fraud; on the Defendant Directors' watch the company implemented such actions, but with insufficient speed and skill. But this allegation simply tells me the Board did a poor job applying its discretion to act; to my mind, this does not reasonably imply bad faith.

Interestingly, the Court contrasted the allegations before it in *Richardson* with two recent cases also involving allegations of failed oversight, *Teamsters Local 443 Health Services & Insurance Plans v. Chou*, and *In re MetLife Inc. Derivative Litigation*. In both of these cases, the plaintiffs had alleged directorial *non-action* in response to red flags regarding compliance deficiencies. In *Chou*, the Court had found the specific allegations sufficient (if

proven) to lead to a substantial likelihood of director liability; in *MetLife*, the Court found that the allegations were insufficient. But in both cases, unlike in *Richardson*, the analysis did not turn on the sufficiency of what the boards had done, because plaintiffs alleged that no remedial actions had been taken. In *Richardson*, in contrast, the plaintiff alleged that the directors took action, but that it was insufficient or ineffective. As the Court concluded:

> The facts pled here suggest a failed effort, not one opposed to the interests of MoneyGram or otherwise in bad faith. It is conceivable that a purported attempt at remediation could constitute bad faith; for instance, a mere sham remediation or an insincere action to fool regulators may be actionable…. If a failed directorial attempt to remediate a problem is, because of its failure, actionable, a perverse incentive will be created.

The Court's reasoning, and differentiation between failed attempts at compliance on the one hand, and an absence or lack of effort on the other, provides important guidance to directors faced with mission-critical compliance situations. The decision also reaffirms the principle espoused in many of the long line of decisions since the original *Caremark* decision that a claim of bad-faith oversight failure is among the most difficult claims for a stockholder-plaintiff to advance.

Delaware Court of Chancery Allows Breach of Fiduciary Duty Claims Stemming From CBS-Viacom Merger to Proceed

On December 29, 2020, the Delaware Court of Chancery denied a motion to dismiss breach of fiduciary duty claims against National Amusements, Inc. (NAI), Viacom Inc.'s controlling stockholder; Shari Redstone, the director, president, and controlling stockholder of NAI; and four individual NAI directors. All were sued for their roles in the Viacom/CBS Corp. merger in a decision that is important for mergers in which a controlling party stands on both sides of a transaction and receives nonratable benefits that are measured in terms of control, rather than based on merger consideration.

As to the claims against NAI and Ms. Redstone, the Court applied the entire fairness standard of review and held that the plaintiffs had pleaded adequately that the transaction was not entirely fair, but "without prejudice" to the defendants' right to argue entire fairness does not apply "on a more developed record." As to the directors, the Court sustained the allegations that they acted under a "controlled mindset" sufficient to state a breach of loyalty claim that would not be barred by the company's Section 102(b)(7) exculpatory provision.

The decision by Vice Chancellor Joseph Slights stems from the December 2019 CBS/Viacom merger. According to the complaint, Sumner Redstone (the late owner, CEO, and chairman of NAI) "made clear his desire that the boards of Viacom and CBS select his successor because, in his view, his daughter, Shari Redstone, was not suitable for the job." But in 2016, Mr. Redstone's health deteriorated and Ms. Redstone allegedly "began to whittle away at the governance protections her father had installed" by replacing long-time executives from NAI. The plaintiffs, a class of Viacom stockholders, allege that the controlling stockholders of both Viacom and CBS caused the merger on terms "detrimental to Viacom and its public stockholders." The plaintiffs allege that Ms. Redstone exerted control over Viacom fiduciaries in a manner that caused them to negotiate and approve the merger out of loyalty to her rather than in Viacom's interests.

The parties heavily disputed which standard of review the Court should apply: The plaintiffs argued that entire fairness should apply since a controller stood on both sides of the transaction, while the NAI Parties posited that the "mere presence" of a controller alone is not sufficient to trigger entire fairness review and therefore the business judgment rule

should apply. First, the Court noted that there were no "MFW dual protections" that would have triggered business judgment review. Coined after *Kahn v. M&F Worldwide Corp.*, 88 A.3d 635 (Del. 2014), "MFW dual protections" permit business judgment review of a merger when the merger is approved by both (1) an independent special committee and (2) a majority of minority stockholders. Ultimately, the Court held that the merger "was a 'conflicted transaction' beyond NAI's [mere] presence on both sides."

The Court also held that the plaintiffs pleaded Ms. Redstone received a "non-ratable benefit from the Merger at the expense of Viacom's minority stockholders," and this required review pursuant to the entire fairness standard. "A non-ratable benefit exists when the controller receives a unique benefit by extracting something uniquely valuable to the controller, even if the controller nominally receives the same consideration as all other stockholders." Typically, however, there is "no cause to apply the nonratable framework in the merger context where the controller stands on both sides of the transaction but received the same consideration as all other stockholders."

However, the Court held that "[t]he Plaintiffs' well-pled allegations create a reasonable inference that Ms. Redstone, through NAI, used the Merger as a means to consolidate her control of Viacom and CBS at the expense of the Viacom minority stockholders" – a nonratable benefit. The Court therefore held that "Ms. Redstone received a unique benefit at the expense of the minority stockholders" given "Ms. Redstone['s] long desire to combine the media companies her father had built in order to consolidate her control of both companies and solidify her status as media mogul." This mandated application of the entire fairness standard, and denial of the NAI Parties' motion to dismiss since "Defendants do not seriously argue that Plaintiffs have failed to well-plead the merger was not entirely fair, and for good reason."

The Court evaluated claims against each of the four directors comprising the Viacom Committee separately. It bears noting that Viacom's charter included a Section 102(b)(7) provision, exculpating individual directors for breach of fiduciary duty claims, with the exception of, inter alia, claims for breach of the duty of loyalty. "To state a 'non-exculpated claim for breach of fiduciary duty against an independent director protected by an exculpatory charter provision,' the plaintiffs must allege 'facts supporting a rational inference that the director . . . acted to advance the self-interested party from whom they could not be presumed to act independently . . . .'"

The plaintiffs contended that they allege a non-exculpated claim against each of the Viacom Committee defendants because they allege the "willingness of the fiduciaries . . . to allow Ms. Redstone to dominate their decision-making rendered them servile tools in Ms. Redstone's relentless pursuit of a Viacom/CBS combination to advance her interests." The Court held that the personal relationship of defendant Nicole Seligman "standing alone present[ed] a reasonably conceivable case that Ms. Seligman was not independent of the NAI Parties with respect to the Merger." Specifically, Seligman was President of Sony (a longtime customer of NAI), served on a nonprofit board with Ms. Redstone, and was known to attend trade and professional events with Ms. Redstone; a *Wall Street Journal* reporter described Seligman and Ms. Redstone as "BFFs"; the *New York Post* called Seligman Ms. Redstone's "closest advisor"; and Ms. Redstone allegedly emailed Seligman and stated "I need another you [for the CBS Board], but obviously it can't be you . . . Miss you tons . . . we can grab coffee next Friday."

As to the other individual defendants, the Court held that "[a]s pled, the Viacom Committee's negotiations reflect[ed] a desire to placate the controller, not to land the best transaction possible for all Viacom stockholders" and therefore it was "reasonably conceivable that the Viacom Committee Defendants allowed NAI's influence over them to impede their role in disabling NAI's self-interest and ensuring that the best interests of all Viacom stockholders were loyally represented in the negotiation and consummation of the Merger." Ultimately, the Court held that "Plaintiffs have well pled that the Viacom

Committee operated under a controlled mindset" and denied the motion to dismiss breach of fiduciary duty claims against the Viacom Committee defendants.

The Court's decision to apply entire fairness is significant because, as the Court itself noted, cases in which the business judgment rule apply rarely make it past the "proverbial starting line. If, on the other hand, the court reviews the conduct under the entire fairness standard, the claim is likely to proceed at least through discovery." Although the Court's discussion of "mere presence" is dicta, it provides important insight that future decisions from the Court of Chancery will find that the mere presence of a controller on both sides of a merger alone is sufficient to trigger entire fairness review in the absence of *MFW* dual protections (*i.e.,* that the merger is approved by an independent special committee and a majority of the minority stockholders). It also reminds that while a controller who receives the same consideration as others may not trigger the "nonratable" benefit analysis, the receipt of control-related intangible benefits may suffice.

Durham v. Grapetree, LLC: A Helpful Affirmation of the Limits on the Scope of Section 220 Inspections in the Context of Email and Text Communications

A short decision issued in January by the Delaware Supreme Court provides helpful insight into an issue of practical import in the context of Section 220 demands: When does a stockholder have a right to go beyond formal communications, such as board minutes, presentations, and resolutions, to conduct a more invasive and burdensome search of informal methods of communication, such as text messages and emails? *Durham v. Grapetree, LLC* (Del. Jan. 11, 2021).

Durham v. Grapetree provides evidence that Delaware courts will not permit a stockholder to perform an invasive and expensive email search to inspect informal records where formal records (e.g., board minutes, resolutions and presentations) relating to the matters under inspection are available.

Recent decisions by Delaware courts have been much remarked upon, including in a recent post on Sidley's Enhanced Scrutiny Blog, for affirming the breadth of "proper purpose" that courts will view as sufficient for a stockholder plaintiff to state in order to be permitted to inspect a company's books and records.

In each of these decisions, however, courts have continued to emphasize that whether a stockholder plaintiff is permitted any inspection at all does not end the inquiry. Section 220 requests are not intended to allow "indiscriminate fishing expeditions" or overly broad inquisitions that are akin to discovery in litigation. Instead, the stockholder is limited to inspection of documents that are "necessary and essential" to the "proper purpose" the stockholder asserts for inspection. Accordingly, it is axiomatic that, even where a stockholder states a proper purpose, the scope of records the stockholder is permitted to inspect must be circumscribed with "rifled precision."

In some tension with the quintessential limited nature of the Section 220 proceeding has been Delaware courts' consistent affirmation in recent years that emails, text messages and other informal communications are within the realm of documents that might be found "necessary and essential" to a stockholder's purpose. While not as extensive as discovery in litigation, even a targeted email and text message search of a company's most senior officers and directors can be time-consuming and expensive.

Beginning in 2019, in a welcome and less-remarked-upon parallel track to the courts' decisions affirming the breadth of the "proper purpose" requirement, the Delaware Supreme Court has provided guidance and concrete limitations on when "informal" communications, including emails and text messages, will be found "necessary and essential." Specifically, whether those communications are necessary will depend on the company's recordkeeping and communication practices. Where key communications are documented by letter, in board minutes and resolutions, or via similar formal mechanisms, it is not necessary or essential for a stockholder to delve into more informal communications. But, where the key matters for inspection are not documented in any formal manner, the

lack of formal communications should not stand as a bar to inspection, and the stockholder may be permitted to search informal communications.

While previous decisions arose in the context of a company that failed to properly document the matters at issue (necessitating broader inspection of informal communications), *Durham v. Grapetree* affirms the importance of the guidelines set out in those decisions. In that case (which arose under a different statute governing limited liability companies that Delaware courts consistently hold should be interpreted in a similar manner to Section 220 in this regard), the Court affirmed a decision of the Delaware Court of Chancery denying inspection of informal records where board presentations and minutes concerning the matters for inspection were available. This decision provides evidence that, in the arguably more run-of-the-mill context in which an inspection seeks information regarding matters, for instance regarding corporate management, that have been documented in formal materials, Delaware courts will not permit a stockholder to perform an invasive and expensive email search. Stockholder plaintiffs are entitled to such informal communications only if they are necessary, not simply because they would like to know more about a particular matter.

CORPORATE GOVERNANCE DEVELOPMENTS

BlackRock and State Street Annual Letters Focus on Climate Change and Diversity

In his 2021 annual letter to CEOs, BlackRock CEO Larry Fink expressed his belief that the COVID-19 pandemic accelerated a "tectonic shift" toward sustainable assets, and he anticipated that over time a broader group of investors (beyond the largest) will demand more customized index portfolios with sustainability focus. BlackRock is calling for a single global standard for ESG disclosure to allow investors to make better informed voting and investment decisions. In the meantime, BlackRock continues to endorse the ESG disclosure framework of the Sustainability Accounting Standards Board (SASB) and the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD). BlackRock believes that not only public companies but large private companies should adopt TCFD, and that all issuers of public debt should disclose how they are addressing climate-related risks. BlackRock expects all public company boards to incorporate climate risk as part of their oversight of long-term strategies. Specifically, BlackRock asks companies to disclose a board-reviewed plan for how their business will comport with a net zero economy – one that emits no more carbon dioxide than it removes from the atmosphere by 2050, the scientifically-established threshold necessary to keep global warming well below 2°C – and describe how the plan fits into their long-term strategy. Finally, BlackRock asks companies to disclose in their sustainability reports their long-term strategies for improving diversity, equity, and inclusion.

In March 2021, BlackRock released its 2021 engagement priorities that build upon the sustainability and governance themes outlined in Mr. Fink's annual letter. The five engagement priorities are: (1) board quality and effectiveness, (2) climate and natural capital, (3) corporate strategy, purpose and financial resilience, (4) incentives aligned with value creation and (5) human capital impacts. For each engagement priority, BlackRock identified key performance indicators (KPIs) that outline its expectations for related company actions and disclosures.

In his 2021 annual letter to directors, Cyrus Taraporevala, the President and CEO of State Street Global Advisors (SSGA), noted that this year SSGA will prioritize systemic risks associated with climate change and a lack of racial and ethnic diversity – and will hold boards and management accountable for enhancing disclosures on these topics. Ms. Taraporevala said SSGA will continue to engage with companies that are underperforming in the R-Factor scoring system, based on the SASB framework and focused on "financially-material, industry-specific ESG risks." Specifically, SSGA plans to engage with companies to

In March 2021, SSGA released updated proxy voting and engagement guidelines along with a summary of material changes, including the new guidelines to vote against nominating and governance committee chairs for deficient diversity disclosures.

understand their "approaches to mitigating and managing the physical and transitional impacts of climate change," focusing on "specific companies especially vulnerable to the transition risks of climate change" and other companies that, "while not as carbon intensive, also face risks such as the physical impacts of climate change."

Mr. Taraporevala then discussed recent efforts by SSGA to proactively address racial and ethnic diversity. He referenced SSGA's new Guidance on Enhancing Racial and Ethnic Diversity Disclosure and described important new proxy voting guidelines. Beginning in 2021, SSGA will vote against nominating and governance committee chairs at S&P 500 companies that do not disclose the racial and ethnic composition of their boards. Beginning in 2022, SSGA will vote against compensation committee chairs at S&P 500 companies that do not disclose their EEO-1 Survey responses. Finally, beginning in 2022, SSGA will vote against nominating and governance committee chairs at S&P 500 companies that do not have at least one director from an underrepresented community on their boards.

As investors become increasingly focused on climate and ESG issues, public companies should reassess their current climate and 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.

Nasdaq Substantially Amends Its Board Diversity Proposal in Response to Public Comments

In December 2020, the Nasdaq Stock Market LLC filed a proposal with the SEC to adopt new listing standards that would increase the expectations for board diversity and related disclosures at the approximately 3,000 companies listed on Nasdaq's U.S. exchange. Under the original proposal, summarized in our December 2020 issue of *Sidley Perspectives*, the new listing rules would require Nasdaq-listed companies to:

- publicly disclose diversity statistics regarding their boards in a standardized disclosure matrix template; and
- have, or explain why they do not have, at least two diverse directors, including one who self-identifies as female and one who self-identifies as either an underrepresented minority or LGBTQ+.[4]

In response to more than 200 public comments received by the SEC on the original proposal, Nasdaq submitted a substantially amended proposal to the SEC on February 26 along with a letter outlining the revisions and addressing "common misconceptions" commentators had about the proposal. The most noteworthy modifications are discussed below:

- **Format and location of disclosure.** All Nasdaq-listed companies would be required to annually disclose specified board-level diversity statistics (gender, race/ethnicity, and LGBTQ+) in Nasdaq's board matrix diversity template (or a substantially similar format) in a searchable format on their websites or in their proxy statements (or Form 10-K or 20-F if they do not file a proxy statement). Nasdaq revised its board diversity matrix template and clarified that if a company provides such disclosure on its website, it must publish it concurrently with its proxy statement (or Form 10-K or 20-F filing) and submit a URL link to the disclosure to Nasdaq within one business day after posting. The amended proposal also clarified that a company may include supplemental data in addition to the information required to appear in the board diversity matrix.
- **Deadline for disclosure of the board diversity matrix.** Under the proposal, a listed company must publish its board diversity matrix by the later of (1) one calendar year from the date on which the SEC approves the amended proposal or (2) the date the company

4 For purposes of the proposed listing standard, an "underrepresented minority" means an individual who self-identifies as one or more of the following: Black or African American, Hispanic or Latinx, Asian, Native American or Alaska Native, Native Hawaiian or Pacific Islander, or Two or More Races or Ethnicities. "LGBTQ+" means an individual who self-identifies as any of the following: lesbian, gay, bisexual, transgender, or a member of the queer community.

files its proxy statement (or if the company does not file a proxy statement, its Form 10-K or 20-F) for its annual shareholder meeting during the calendar year in which SEC approval occurred.

- **Timing of disclosure of explanation for non-compliance with diversity requirement.** Under the proposal, if a listed company makes disclosure explaining why it does not meet the applicable diversity requirement, the company must provide this disclosure in advance of the next annual shareholder meeting in any proxy statement (or Form 10-K or 20-F filing) or on its website. If a company provides such disclosure on its website, it must publish it concurrently with its proxy statement (or Form 10-K or 20-F filing) and submit a URL link to the disclosure to Nasdaq within one business day after posting.
- **Lower threshold for smaller boards.** A listed company with five or fewer directors may satisfy the diversity requirement by having, or explaining why it does not have, at least one diverse director rather than two.
- **One-year grace period for vacancies.** A listed company that no longer meets the diversity requirement due to a vacancy on the board (*e.g.*, a diverse director resigns or has a health emergency) would have a one-year grace period during which to regain compliance.
- **Extended phase-in periods.** Under the original proposal, listed companies would be required to have (or explain why they do not have) at least one diverse director within two years after the SEC approves the proposal and at least two diverse directors either within (1) four years of SEC approval for companies listed on the Nasdaq Global Select or Global Market tiers or (2) five years of SEC approval for companies listed on the Nasdaq Capital Market tier. A listed company on any tier with five or fewer directors would be required to have (or explain why it does not have) at least one diverse director within two years of SEC approval. Under the amended proposal, after the initial four or five year phase-in period expires, newly listed companies on Nasdaq (*e.g.*, IPOs, direct listings, companies listing in connection with de-SPAC transactions) must meet the diversity requirement (or explain why they do not) by the later of two years from the date of listing or the date the company files its proxy statement (or Form 10-K or 20-F if the company does not file a proxy statement) for the company's second annual meeting of shareholders after the company's listing. Companies that list on Nasdaq before the initial four or five year period expires would have the remainder of the applicable initial four or five year phase-in period or two years from the date of listing, whichever is longer, to meet the diversity requirement.

The SEC is accepting public comments on the amended proposal for 21 days after it is published in the *Federal Register*. The deadline for the SEC to approve the proposal is August 8, 2021. Nasdaq has published a resource for listed companies and 40 FAQs (both of which will be continually updated) that clarify several aspects of the proposal and provide practical guidance regarding implementation.

Nasdaq-listed companies should evaluate their board composition and related proxy statement disclosures in light of the rule proposal. They should also consider supplementing their D&O questionnaires to request demographic information about directors and their consent to the company publicly disclosing that information.

Glass Lewis Outlines Expectations for Companies Holding Virtual-Only Annual Shareholder Meetings

After holding shareholder meetings virtually in 2020 as a result of the COVID-19 pandemic, many public companies are considering holding shareholder meetings in a virtual-only or hybrid (*i.e.,* both virtual and in-person) format in the future.

In January 2021, acknowledging that virtual shareholder meetings may become the "new normal," proxy advisor Glass Lewis & Co. announced its expectations for companies holding virtual shareholder meetings. If a company chooses to hold its annual meeting in a virtual-

only format, Glass Lewis expects robust disclosure in the proxy statement that assures shareholders that they will be afforded the same rights and opportunities to participate as they would have at an in-person meeting. Glass Lewis provided the following examples of effective disclosure that should appear in the proxy statement and/or on the company's website:

- when, where and how shareholders can ask questions during the meeting (*e.g.*, timeline for submitting questions, types of appropriate questions, rules for how questions and comments will be recognized and disclosed to meeting participants);
- how the board will address appropriate questions received before or during the meeting (including a commitment by the company to answer appropriate questions in a format accessible by all shareholders, such as on the company's annual meeting or investor relations website), especially if shareholders are restricted from asking questions during the meeting; this may include procedures, if any, for posting appropriate questions received during the meeting and the company's answers on the company's investor relations website as soon as practical after the meeting;
- the procedure and requirements to participate in the meeting and/or access the meeting platform; and
- technical support that is available to shareholders before and during the meeting.

In "the most egregious cases" where a company fails to provide this disclosure, Glass Lewis will generally recommend voting against (1) governance committee members, (2) the board chair; and/or (3) other agenda items concerning board composition and performance (*e.g.*, ratification of board acts).

Glass Lewis also expects companies that hold hybrid shareholder meetings to address the disclosure items listed above in their proxy statements or corporate websites. Finally, even for companies that plan to hold their annual meeting in person, at least while COVID-19 travel restrictions remain in place, Glass Lewis believes companies should consider ways to increase shareholder involvement (*e.g.*, allowing shareholders who are unable to attend in-person to view a live webcast of the meeting and to submit questions for directors to address at the meeting).

Glass Lewis supplemented these expectations with a resource detailing topics public companies should focus on when considering whether to hold their 2021 annual meetings virtually. Glass Lewis believes companies should consider (1) whether a virtual meeting is the right format for them, (2) how they can support attendance and participation, (3) whether directors and executives should attend meetings physically, and (4) how their shareholders feel about virtual meetings. The resource also includes specific examples of procedures and technology that companies implemented during virtual meetings last year that Glass Lewis believes enhanced shareholder participation and engagement.

Institutional Shareholder Services (ISS) takes a more lenient approach to virtual meetings than Glass Lewis. ISS has historically favored in-person or hybrid meeting formats but does not have a policy to recommend voting against directors at companies that hold virtual-only meetings. ISS acknowledged that virtual-only meetings were necessary and desirable last year amid the COVID-19 pandemic. In April 2020, ISS issued COVID-19-related policy guidance that encourages companies holding virtual-only meetings to explain why and strive to provide shareholders with a meaningful opportunity to participate fully in the meeting (*e.g.*, engage in dialogue, ask questions of directors and senior management). ISS also encourages boards to commit to return to an in-person or hybrid meeting format (or put the matter to a shareholder vote) as soon as practicable.

Companies should keep these updated policies in mind when planning for their 2021 annual meetings, including the meeting format and mechanics and related proxy statement disclosures.

SEC DEVELOPMENTS

SEC Gears Up to Tackle Climate and ESG Disclosure

Several recent developments at the SEC demonstrate an escalating focus on climate and ESG-related matters. First, on February 1, the SEC announced that it named Satyam Khanna as Senior Policy Advisor for Climate and ESG in Acting SEC Chair Allison Herren Lee's office. In this newly created role, Ms. Khanna will be responsible for advising the SEC on climate risk and ESG matters and coordinating and advancing the SEC's initiatives in this area.

As investors continue to seek greater transparency about climate-related issues, Chair Lee announced on February 4 that she directed the Division of Corporation Finance (Corp Fin) to scrutinize the climate-related disclosures made in public company filings. In addition to generally assessing compliance with disclosure obligations under the federal securities laws, the Corp Fin staff will specifically review whether a company has addressed the topics outlined in the SEC's 2010 interpretive release which provided guidance to public companies as to how existing SEC disclosure requirements apply to climate change matters. Chair Lee also instructed the staff to engage with public companies to study how they are managing climate-related risks. The staff is expected to use the lessons learned to begin refreshing the 2010 guidance.

Acting SEC Chair Lee: "Ensuring compliance with the rules on the books and updating existing guidance are immediate steps the agency can take on the path to developing a more comprehensive framework that produces consistent, comparable, and reliable climate-related disclosures."

During his confirmation hearing on March 2, President Joe Biden's nominee for SEC Chair Gary Gensler signaled that, if confirmed, he would ask the SEC to take a closer look at requiring public companies to disclose information about political contributions, climate-related risks, and workforce diversity in light of strong investor interest in those topics. Mr. Gensler noted that his assessment of any new disclosure requirements would be grounded in the legal concept of materiality – that is, what a reasonable investor would want in the context of the total mix of information available when making voting and investment decisions – as well as economic analysis.

On March 4, the SEC announced the creation of a 22-member Climate and ESG Task Force in its Division of Enforcement. The stated purpose of the task force is to "develop initiatives to proactively identify ESG-related misconduct," including by using data analytics to detect potential violations and by evaluating and pursuing ESG-related whistleblower complaints. Initially, the task force will focus on uncovering material omissions or misstatements about climate risks in public company disclosures under existing rules. It will also analyze disclosure and compliance issues relating to the ESG strategies of investment advisers and funds. The task force will work closely with the new Senior Policy Advisor for Climate and ESG, Corp Fin, the Divisions of Investment Management and Examinations, and the Office of the Whistleblower.

In response to these recent developments, the SEC's two Republican Commissioners Hester Peirce and Elad Roisman released a statement on March 4 pointing out that the SEC's "disclosure regime encompassed climate-related issues" for years, including prior to the release of the SEC's 2010 guidance on climate change disclosures. They signaled a desire for caution in taking decisive action in this area too rapidly, stating:

> Given this history, we assume that the new initiative is simply a continuation of the work the staff has been doing for more than a decade and not a program to assess public filers' disclosure against any new standards or expectations. After all, the Commission has not voted on any new standards or expectations relating to climate-related disclosure. The timing of this release – just before many public companies were due to file their annual reports – underscores its apparent function as a re-framing of the ongoing work, rather than the announcement of anything new.

Commissioners Pierce and Roisman also suggested that announcing an ESG-specific enforcement initiative was premature – and would more logically be launched after the SEC has had an opportunity to review and update its 2010 guidance.

On March 11, John Coates, the Acting Director of the Corp Fin, published a statement expressing his view that the SEC should help lead the effort to develop an "adaptive and innovative" ESG disclosure system that will provide investors with useful, comparable and reliable ESG-related information. Acknowledging that "there is no one set of metrics that properly covers all ESG issues for all companies," Mr. Coates raised several questions to consider when developing an ESG disclosure system including (1) what disclosures would be most useful, (2) how much standardization can be achieved across industries, and (3) what is the best way to verify or provide assurance about disclosures.

On March 15, Chair Lee delivered a speech explaining why "climate and ESG are front and center for the SEC" and outlining the SEC's plans to work toward a comprehensive ESG disclosure framework. Potential action items Chair Lee mentioned include: (1) issuing guidance to encourage reporting on workforce diversity, (2) issuing guidance or rules on board diversity, and (3) requiring corporate political spending disclosure. Chair Lee also indicated that she asked the SEC Staff to consider (1) proposals to revise SEC or SEC Staff guidance on the no-action relief process and potentially revamp Exchange Act Rule 14a-8, (2) recommending that the SEC re-open the comment file and finalize the 2016 universal proxy rule proposal, (3) recommendations for improving the SEC's 2019 guidance on proxy voting responsibilities of investment advisers, and (4) updates to Form N-PX disclosures to increase transparency around fund proxy voting.

The SEC launched a new page on its website in March 2021 highlighting Commission actions and other SEC responses to the increased investor demand for information about climate and ESG risks and opportunities.

On the same day Chair Lee announced that the SEC is inviting public comment on climate disclosure. Chair Lee's statement sets forth 15 sets of questions that the SEC invites investors, public companies, and other market participants to answer to inform the SEC Staff as it considers rule amendments aimed at making climate disclosure more consistent, comparable, and reliable. Key questions include: (1) what data and metrics are most useful to investors, (2) to what extent should the SEC take an industry-specific approach, (3) what can be learned from existing voluntary frameworks, and (4) how to design a climate disclosure regime that is sufficiently flexible to stay current with market and scientific developments. The SEC will accept comments through June 13, 2021.

The developments described above make clear that climate and ESG-related matters will be a high priority for the SEC under the Biden administration. Public companies can expect a combination of enforcement, guidance, and rulemaking from the SEC in the near term on climate and other ESG topics. In the meantime, with the SEC sharpening its focus on climate-related disclosures, public companies should confirm that their disclosures are accurate and complete and that they have adequately addressed the following topics outlined in the SEC's 2010 guidance as they relate to climate change:

- impact of legislation and regulation;
- the impact of international accords;
- indirect consequences of regulation or business trends; and
- physical impacts on their business operations and results.

SIDLEY RESOURCES

M&A Topics

Creative Deal Structures: Energizing the M&A Market Post-Crisis (March 2021). Sidley partnered with Mergermarket to produce a report based on the results of a survey of 150 U.S.-based executives of corporations and private equity firms conducted in November 2020. The report focuses on the M&A environment coming out of the pandemic, with an emphasis on innovative deal structures being used to bridge the gap between sellers' expectations and buyers' willingness to pay. Key findings from this report:

- 63% of respondents who use alternative structures say more of their recent deals have incorporated such mechanisms than has historically been the case. Among private equity firms, the figure was 68%.
- The proportion of private equity firms expecting to be involved in SPAC-related transactions is significantly higher (69%) than among corporates (31%).
- Among respondents likely to use alternative deal structures, energy, mining & utilities, and industrials & chemicals were the sectors where they expected the most use.

Shareholder Activism Topics

Shareholder Activism, Hostile M&A, and Related Issues for the 2021 Proxy Season. The foregoing link is to the transcript from the latest episode of *The Sidley Podcast*, where Sidley partner Sam Gandhi speaks with the firm's thought leaders on shareholder activism – Beth Berg, Kai Liekefett and Derek Zaba – about a number of key issues related to this year's proxy season and beyond. They also discuss the interplay between shareholder activism and hostile M&A, including as to how ESG may impact activism.

Corporate Governance Topics

Board Considerations for an Uncertain 2021. In an article published in the December 2020/January 2021 edition of Practical Law's *The Governance Counselor*, Holly J. Gregory, a partner in Sidley's New York office, explores the issues that boards will face in 2021 given the current economic uncertainty, social unrest, and COVID-19 pandemic. Against this backdrop, interrelated trends have emerged, including:

- renewed interest in the company's purpose in society, including its role in providing the goods and services that meet basic needs, as well as in innovation;
- shifting emphasis from shareholder primacy to the interests of a broader set of stakeholders;
- accelerating interest in ESG matters, particularly the company's role in addressing social issues, including issues of racial and gender equality and social justice;
- enhanced focus on the value of human capital and related changes in the nature of work and the workplace; and
- the potential for significant reconfiguration of industries and business models, which raises concerns about business continuity.

ISS Significantly Expands Governance QualityScore; ISS and Glass Lewis 2021 Policy Updates Now in Effect (Feb. 16, 2021). ISS recently announced new factors and other methodology updates to its ISS ESG Governance QualityScore corporate governance scoring tool, including 11 new factors relating to a company's oversight and management of information security risk and new questions addressing board diversity, director independence, and compensation-related matters. This Sidley Update summarizes the Governance QualityScore updates applicable to U.S. companies. It also covers the ISS and Glass Lewis proxy voting policy updates now in effect for the 2021 proxy season. The key policy updates relate to board diversity and related disclosures, director tenure, board oversight of environmental and social risk, virtual shareholder meetings, ESG-related shareholder proposals, and compensation-related matters. Appendix A provides a detailed summary of the ISS and Glass Lewis proxy voting policy updates that apply to U.S. companies and discusses their practical implications. Appendix B includes a comprehensive list of the various circumstances in which ISS and Glass Lewis may recommend votes against directors in an uncontested election.

SEC Topics

Preparing Your 2020 Form 10-K: A Summary of Recent Key Disclosure Developments, Priorities, and Trends (Jan. 13, 2021). This Sidley Practice Note highlights certain key

disclosure considerations for preparing your annual report on Form 10-K for fiscal year 2020, including recent amendments to SEC disclosure rules and other developments that will affect 2020 Form 10-K filings as well as certain significant disclosure trends and current areas of SEC staff focus for disclosures. Appendix A sets forth a summary checklist of significant Regulation S-K amendments affecting 2020 Form 10-K filings.

Antitrust; HSR Topics

Court of Appeals Upholds Divestiture Order in Merger Challenge by a Private Party (Feb. 25, 2021). The U.S. Court of Appeals for the Fourth Circuit recently upheld a district court order requiring a company to divest assets it had acquired nine years before after a private plaintiff convinced a jury that the acquisition violated the antitrust laws. The case provides a stark reminder that transactions can be challenged under the antitrust laws long after they have closed, even when they had previously cleared government antitrust review, and that parties to a strategic transaction, particularly buyers, should take care to avoid steps that could provide customers or others reasons to either complain to the government or bring suit.

FTC Releases 2021 Thresholds for Hart-Scott-Rodino Filings and Interlocking Directorates, Raises Maximum Per Diem HSR Penalty (Feb. 2, 2021). Effective March 4, 2021, the minimum "size of transaction" threshold for any acquisition of voting securities, noncorporate interests or assets not exempt from the Hart-Scott-Rodino (HSR) Act's notification requirements decreased from $94 million to $92 million. Other thresholds related to these filings and to the Clayton Act Section 8's prohibition against interlocking directorates were also adjusted for 2021. Additionally, the maximum per diem civil penalty amount for HSR violations is now $43,792 per day.

SIDLEY SPEAKERS

The ABA's Business Law Section will hold its spring meeting virtually April 19-23. Beth Berg, a partner in Sidley's Chicago office, will participate in a panel titled *The New Shareholders' Meeting Handbook* on April 21. Click here for more information.

Holly J. Gregory, a partner in Sidley's New York office, will participate in the following upcoming speaking engagements:

- A panel titled *Board Governance: The Board's Agenda 2021 and Beyond* for the Association for Corporation Counsel on a webinar on April 13. Click here for more information.
- A panel titled *ESG: Essential to Corporate Risk Oversight* for the National Association of Corporate Directors (NACD), Pacific Southwest Chapter on a webinar on May 5. Click here for more information.
- A panel titled *Future of Corporate Law: 2020 and Beyond* during the Practising Law Institute's Delaware Law Developments 2021: What All Business Lawyers Need to Know program on May 20. Click here for more information.
- A lecture titled *Women on Boards: What You Need to Know Going In* for participants in the Yale School of Management Women on Boards program on June 8. Click here for more information.

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