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ANALYSIS

SEC UNIVERSAL PROXY RULES AMPLIFY PROXY CONTEST THREATS FOR COMPANIES

By Kai Liekefett, Derek Zaba, and Leonard Wood[1]

Almost a year ago, the U.S. Securities and Exchange Commission (SEC) adopted new Rule 14a-19 and amendments to existing rules under the Securities Exchange Act of 1934 to require the use of "universal" proxy cards in director election contests at publicly traded companies in the U.S. We expect the new rules, which became effective on September 1, 2022, to lead to increased proxy contest threats and confer advantages to dissidents at public companies. Companies and boards of directors should be well informed and prepared for the changing face of shareholder activism that may result from the adoption of the universal proxy card system.

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Overview of the New Rules

The central feature of a contested corporate election at public companies is that shareholders are asked to vote, or give voting instructions by proxy, for two competing slates of director nominees: a "company slate" assembled by the board of directors and a "dissident slate" assembled by one or more dissident shareholders. Under the former system, shareholders received separate proxy cards from the company and dissident that each included only the respective parties' different slates. As such, shareholders were not able to "mix and match" their voting instructions for any combination of director candidates from both slates.

Under the new rules, which are now mandatory in director election contests at public companies, shareholders may continue to receive separate proxy cards from the company and dissident.[2] However, these proxy cards will now include proxy voting options for both the company's and dissident's respective nominees, such that shareholders will be able to vote for any combination of properly nominated candidates up to the number of authorized seats for election at the meeting.

New Mechanics for Contested Proxy Solicitations

The new framework is comprised of a slew of rules that need to be satisfied for companies and dissidents to run legally compliant proxy contests. The dissident and company must both meet certain deadlines. Notably:

- The dissident must provide the company with the names of all dissident nominees at least 60 days prior to the anniversary of the prior year's annual meeting, subject to exceptions. This obligation comes in addition to the dissidents' obligations to comply with any advance notice provisions in a company's governing documents.
- The company must provide the dissident with the names of all company nominees at least 50 days prior to the anniversary of the prior year's annual meeting.
- The dissident must provide prompt notice to the company of any change in the names of its director nominees.
- The dissident must file a definitive proxy statement with the SEC by the later of (i) 25 calendar days prior to the date of the election meeting and (ii) five calendar days after the date the company files its definitive proxy statement.

The new rules require dissidents to solicit the holders of shares representing at least 67% of the voting power of shares entitled to vote on the election of directors and include a

1 Kai Liekefett and Derek Zaba are partners and co-chairs of Sidley's Shareholder Activism and Corporate Defense practice, and Leonard Wood is a senior managing associate at the 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. This article first appeared in *Law360* on September 26, 2022.

2 The universal proxy system is not mandatory for dissident consent solicitations to remove existing company directors and does not apply to director elections at registered investment companies or business development companies.

statement to that effect in its proxy statement. A dissident may choose, alternatively, to use the less costly e-proxy delivery method ("notice and access") that involves mailing a notice of internet availability and posting the proxy materials on a corporate website.

While the new rules require the company and dissident to include each other's respective candidates on both cards, the company and dissident are each permitted to provide their distinct proxy voting recommendations on their separate proxy cards. New presentation, formatting, and disclosure requirements also apply to universal proxy cards. Among these: Proxy cards must clearly distinguish between the company's and dissident's nominees; list nominees in alphabetical order by last name within each group; present all nominees in the same font type, style, and size; and prominently disclose the maximum number of nominees for which authority to vote can be granted. The company and dissident can continue to issue differently colored proxy cards (e.g., white and gold).

In an election contest, the company and the dissident will each be required to include a statement in the respective proxy statement referring shareholders to the other party's proxy statement for information about such other party's director nominees. This rule is a new requirement in Schedule 14A.

The company and dissident will now be able to satisfy certain disclosure obligations in their proxy statements by referring to information that appears, or can be expected to appear, in the other party's proxy statement. Before the adoption of the new rules, Rule 14a-5(c) only permitted parties to cross-reference information that had already been provided in another party's proxy statement. The new rules clarify that a party can now cross-reference information that either has been or "will be" furnished in the other party's upcoming proxy statement.

Implications for Boards and Directors

The new universal proxy system has raised the specter that dissidents who present weak cases for change could now obtain one or two board seats in a proxy contest as long as they present a few higher-quality candidates.

The new universal proxy system has raised the specter that dissidents who present weak cases for change could now obtain one or two board seats in a proxy contest as long as they present a few higher-quality candidates. Institutional Shareholder Services Inc. (ISS), a leading proxy advisory firm, has predicted that under the new system boards will be "far less able to shield their weakest contributors."[3] Glass Lewis & Co. LLC, another leading proxy advisory firm, has suggested similarly that the new rules "will potentially make all incumbent directors on a board more vulnerable for replacement, whether they are specifically identified as a targeted director by the activist or not."[4] These are notable perspectives coming from ISS and Glass Lewis given the significance of their proxy voting recommendations on the outcomes of director elections.

The rationale behind ISS's observation is that the universal proxy system may facilitate a shift in the focus of proxy campaigns from the quality of a party's overall slate to the quality of individual director candidates. In other words, campaign strategies may shift from focusing on company versus dissident platforms, i.e., a slate contest, to pitting an activist's best individual nominees against the company's nominees whom the activist regards as the weakest targets, i.e., a candidate contest. As a result, proxy contests may become more personalized for directors.

Boards of directors should also expect dissidents to use the mere availability of the universal proxy card as an additional source of leverage when they make demands to, and negotiate with, boards. The new regime will not give a dissident an advantage at the ballot box in every case, but it will present the possibility of an advantage in certain situations. Boards can expect dissidents to use that uncertainty to their advantage as a means to negotiate for board seats through a settlement, as an alternative to waging a full proxy contest.

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3 ISS, The UPC Era Begins, Sept. 2, 2022 (last accessed Sept. 21, 2022).

4 Glass, Lewis & Co., The Implementation, and Implications, of Universal Proxy Cards, Sept. 1, 2022 (last accessed Sept. 21, 2022).

Potential Impacts for Special Interest Campaigns

The new system has the potential to open floodgates for special interest groups because it will make it easier and cheaper to run proxy fights. Because the universal proxy allows an activist to require a company to put all candidates on the company's proxy card, an activist no longer needs to mail its own proxy materials multiple times to tens of thousands of shareholders. These cost savings will enable special interest groups with smaller budgets — such as environmental groups, unions, NGOs, and gadflies — to run inexpensive issue-based proxy campaigns. To date, such activists made their cases at shareholder meetings by making advisory proposals about company policies under the Rule 14a-8 shareholder proposal process.

Special interest groups, should they choose, will now be able to nominate directors with environmental or other applicable backgrounds and use these candidacies as leverage to pressure a company to change policies. When commenting on the new universal proxy rules, ISS expressed skepticism about the prospects of proxy contests that would place a narrow focus on environmental, social, and governance (ESG)–themed "upgrades." But ISS also noted that it is receptive to activism campaigns that "connect the dots between ESG issues, operational concerns, and shareholder value." In other words, under the new system, there is a roadmap for activists who would seek to advance ESG themes as a means to bolster activist campaigns otherwise focused on other themes and priorities.

Takeaways for Companies

As public companies prepare for the new universal proxy era, they should update their bylaws to make sure they have appropriate protections if an activist nominates an alternative slate.

As public companies prepare for the new era, we provide the following practical guidance for consideration:

- Companies should expect more activist campaigns. "Tabletop" preparations can aid boards and management teams to this end.
- Given that activist investors may focus on a board's "weakest contributors" (as put by ISS), companies should regularly assess board composition and the suitability of existing directors in light of the company's strategy and potential attack vectors that may be levied by an activist.
- Consider strengthening structural defenses before an activist arrives. In particular, companies should update their bylaws to make sure they have appropriate protections if an activist nominates an alternative slate.
- If faced with a threatened proxy contest, companies should seek expert advice to evaluate potential outcomes of a proxy contest before negotiating with activists and other dissidents over board representation.

INTERLOCKING DIRECTORATE AGENCY INITIATIVE OUTSIDE M&A

By Karen Kazmerzak and Laura Collins[5]

Recent speeches and actions by the Antitrust Division of the U.S. Department of Justice (DOJ) highlight the current administration's focus on finding and prohibiting companies from having representatives on the boards of two competing companies. The DOJ believes that by cracking down on interlocking directorates, it will deter potentially collusive or anticompetitive behavior.

In April, Assistant Attorney General Jonathan Kanter announced that the DOJ was expanding its enforcement of Section 8 of the Clayton Act, the primary antitrust enforcement mechanism limiting service of officers and directors. Where the DOJ had

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generally limited its Section 8 investigations to its standard merger review process, Kanter promised the DOJ would "ramp[] up efforts to identify violations across the broader economy."[6] In September, DOJ followed through on that commitment by requesting information about potential interlocking directorates from a number of companies outside the merger process, apparently based on public information such as lists of directors on company websites or in Form 10-Ks.

Section 8 Overview

A violation of Section 8 is a per se offense, meaning that if the conduct fits squarely within the statute, that conduct is unlawful. The result of finding a violation is that the interlock must be dissolved by the person creating the interlock leaving at least one of the boards. The reason for this treatment goes back to the statute's origins. The interlocking directorate prohibition was enacted due to concerns that competitors could use boardroom activities to facilitate collusion. In 1914, the same year Section 8 was enacted, Louis Brandeis characterized director interlocks between competitors as "the root of many evils."[7]

Section 8 is a prophylactic measure meant to "nip in the bud incipient violations of the antitrust laws by removing the opportunity or temptation to such violations through interlocking directorates." *TRW, Inc. v. Fed. Trade Comm'n*, 647 F.2d 942, 946 (9th Cir. 1981). In addition to covering direct interlocks between competitors, it also applies in cases where the interlock is at the board level and the competition occurs between the controlled subsidiaries instead of the parent companies.[8] It applies not only to individuals who sit on multiple boards but also to entities that have representatives on boards of competing companies. So if Entity A has a representative on the board of Company X and a different representative on the board of Company Y, a competitor of X, that can create a violation of Section 8.

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Jurisdictional Thresholds

Section 8 only prohibits director interlocks between companies that exceed the jurisdictional thresholds, have competitive sales above a de minimis level, and have business activities with or within the U.S. For 2022, the net worth threshold requires that each company have assets exceeding liabilities of $41,034,000 or more. Even if the two companies exceed this threshold, Section 8 would not apply if (i) the competitive sales of either company are less than $4,103,400 (2022 threshold) or less than 2% of its total sales or (ii) if the competitive sales of *each* company are less than 4% of its total sales.

Competition is Defined Broadly

Section 8 prohibits interlocks between companies that are "competitors, so that the elimination of competition between them would constitute a violation of the provisions of *any* of the antitrust laws" (emphasis added). Courts construe the statute broadly to prohibit interlocks between "ostensible competitors" on the basis that "the statute reflects a public interest in preventing directors from serving in positions which involve either a potential conflict of interest or a potential frustration of competition."[9] It applies equally to low levels of competition as it does to those affecting larger segments of commerce.

Courts and the agencies have taken a broad view of what constitutes competition for purposes of Section 8. Companies are considered competitors if (i) they are recognized by the industry as competing, (ii) serve a similar function, and (iii) serve a common market.[10] Courts and the Federal Trade Commission (FTC) have found that a board interlock violated Section 8 even where customers may not be aware of the offerings of both parties, only one

6 Speech, Jonathan Kanter, *Assistant Attorney General Jonathan Kanter Delivers Opening Remarks at 2022 Spring Enforcers Summit* (Apr. 4, 2022), available here.

7 Louis D. Brandeis, *Other People's Money and How the Bankers Use It*, 51 (1914).

8 See, e.g., *In re BorgWarner Corp.*, 101 F.T.C. 863, 910 (1983), 102 F.T.C. 1164 (1983), *modified, rev'd sub nom., Borg-Warner Corp. v. FTC*, 746 F.2d 108 (2d Cir. 1984).

9 *Protectoseal Co. v. Barancik*, 484 F.2d 585, 589 (7th Cir. 1973).

10 *See TRW, Inc.* at 947.

of the companies is able to meet a customer's requirements, and the amount of actual competition between the two parties is de minimis.[11]

One-year Grace Period

Any officer or director who was eligible to serve at the time of his or her election or selection to serve in the position has a one-year grace period after an intervening event to resign from that position. Intervening events would include one of the corporations crossing over the net worth threshold, exceeding the de minimis competitive overlap thresholds, or making an acquisition that results in the two companies becoming competitors. At the moment the intervening event occurs, the director can lawfully serve for one year.

Mitigating Section 8 Risk

With the revitalized interest in Section 8, companies may wish to perform a review to ensure compliance with the law, particularly as Section 8 issues can develop without any action by the company.

With the revitalized interest in Section 8, companies may wish to perform a review to ensure compliance with the law, particularly as Section 8 issues can develop without any action by the company—for instance, if it has a director seated on the boards of Companies X and Y, which historically did not compete, but Company X enters a new line of business that competes with Company Y and crosses the competitive revenue threshold. In conducting a review of potential interlocks, companies may consider prioritizing review of public companies and companies with board information available publicly. If a potential interlock exists or might appear in the near future, antitrust counsel can help to confirm the issue and examine the potential applicability of any exemptions.

Other Antitrust Considerations

Even if the interlocking directorate may not be prohibited, other antitrust laws may require that the officer or director take steps to recuse himself from participation in certain decisions and not access certain information provided to the board that is directly relevant to the competitive overlap.

- The FTC has applied Section 5 of the FTC Act (which broadly declares "unfair methods of competition…unlawful") to enforce the "spirit and policy" of Section 8 to reach interlocks that Section 8 may not prohibit, such as interlocks between entities that are not corporations.
- Interlocks may be deemed part of an unlawful conspiracy under Section 1 of the Sherman Act, which prohibits director interlocks that unreasonably restrain trade. Accordingly, even where Section 8 of the Clayton Act does not prohibit an interlock—e.g., where a de minimis exception is available (see below)—appropriate safeguards (e.g., information firewalls or recusals) should be considered as means of preventing impermissible communications between the firms involved.

Enforcement

Section 8 can be enforced through actions brought by the DOJ or the FTC. Private parties also may sue under Section 8. The principal remedy for a violation is elimination of the interlock and, possibly, prohibition of future interlocks. Damages are theoretically available to private plaintiffs, but we know of no case where they were awarded.

Section 1 of the Sherman Act increases the risk of liability (including treble damages) to the company if the company receives nonpublic competitively sensitive information about its competitor through the board representation or the board pulls its competitive punches based on the interlock.

Mitigating Antitrust Risk When Section 8 Does Not Apply

In cases where the interlock falls outside Section 8 coverage, companies would need to resolve the Section 1 and Section 5 issues. Such measures would require that interlocked

11 See *TRW*, Inc. and also a 1984 FTC Advisory Opinion available here regarding the proposed SCM Corporation/Bohemia, Inc. interlock (finding potential interlock despite no known direct competition between the two companies for sales to the same customer and combined market share of less than 1%).

directors be restricted from receiving competitively sensitive information that they could use in their role as directors of the other boards. To the extent there is an overlap, such a protocol often includes the interlocked director's removal and recusal from meetings, decisions, and other communications that relate to the competitive overlaps. The protocol also often would restrict interlocked directors from seeing any nonpublic competitively sensitive information about the competitive overlap unless it is in an aggregated form that does not state, identify, or describe any competitively sensitive information.

ESTABLISHING NORMS FOR DIRECTOR BEHAVIOR TO ENHANCE BOARD CULTURE AND EFFECTIVENESS

By Holly J. Gregory[12]

Given that the board is often constrained in its ability to take meaningful action against a director who strays from agreed policies and norms, attending to the health of the board's culture by underscoring what is expected is an important preventive measure.

Board culture — the shared values, beliefs, assumptions, and expectations that influence behavior in the boardroom — plays a considerable role in the board's ability to govern in an effective and efficient manner. It affects how directors engage with one another and with management, the candor with which differing viewpoints are raised and deliberated, and the ease with which directors determine priorities and reach consensus. A positive board culture marked by trust, respect, and candor provides the foundation for collaborative and constructive discussions as the board assesses corporate opportunities and risks, manages transitions, and navigates crisis. Attentiveness to issues of board culture in normal times helps boards withstand stress in times of volatility and crisis.

The Value of Positive Behavioral Norms

Effective governance depends on how directors weigh in with their perspectives, stimulating discussion that challenges assumptions and biases in constructive ways. Moving from identification and deliberation of options and alternatives to formation of consensus (or at least a majority agreement) in an efficient manner requires a positive board culture built on norms for how directors will conduct themselves in undertaking their service as fiduciaries and in interacting with one another and management.

The Legal Framework

The board's authority to act is as a collective body. Individual directors are fiduciaries who have duties to act with care, loyalty, and good faith in participating in board activities and decisions. Individual directors do not have authority, unless delegated by the board, to authorize action by the company, bind the company to agreements, issue directives to members of management or other employees, or speak on behalf of the board or company.

In monitoring performance and determining how to vote on a matter, directors are expected to review all relevant information reasonably available. In addition to considering information provided by management, experts, and advisors, directors should consider the views of other directors that are explored and developed in board and committee deliberations, including as the board works toward building a consensus about potential courses of action. Well-functioning boards are normally able to achieve a consensus that all directors can support, only rarely resorting to a majority position that a minority of directors opposes. However, reasonable directors may disagree on important matters from time to time.

Expectations for Director Behavior

For a board to be effective as a decision-making body in which a variety of views are raised, explored, and debated, directors must respect, trust, and rely on one another and at times defer to one another's judgment. From a board culture perspective, the goal is to achieve a

12 Holly J. Gregory is a partner and co-chair of Sidley's global Corporate Governance and Executive Compensation practice. The views expressed in this article are those of the author and do not necessarily reflect the views of the firm, its other lawyers, or its clients. An unabridged version of this article was published in the Fall 2022 edition of *Practical Law The Journal*.

supportive atmosphere where dissent and disagreement can be both expressed and resolved. A well-functioning board culture encourages directors to ask questions and engage in healthy skepticism. Ideally, directors develop an understanding of one another's styles and strengths and adapt to, and accommodate, one another's weaknesses.

Abiding by agreed behavioral norms helps develop trust and a cooperative and collegial atmosphere among directors that supports the candor and rigorous discussion that is fundamental to the deliberative process. This helps the board resolve disagreements, reach a consensus, and make timely decisions. Generally, directors are expected to:

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- show respect for one another and for executives and employees, including respect for expertise and viewpoints
- listen actively, with an open mind
- be constructive in questions directed to management or other directors
- promote discussion and debate, including through the exercise of self-control in the use of discussion time, respecting the interests of other directors to also participate
- commit to working towards a consensus after an informed and deliberative process
- support, and not undermine, decisions reached by the board
- protect board confidentiality
- avoid acting or speaking on behalf of the company or board without authorization
- raise any concerns in as open and transparent a manner as possible
- identify and disclose conflicts of interest and recuse themselves from discussion of and voting on these matters

Dissenting Behavior

Directors should freely share their viewpoints in board and committee meetings and seek to persuade other directors through deliberations. After thorough discussion, it is uncommon for a director to continue to disagree with what is apparent as the emerging position of the board majority, and the director often votes in favor of the emerging majority position out of respect for and reliance on the informed judgment of the other directors.

A director who disagrees with a board position should consider their own assumptions and biases to identify the source of the disagreement and should be particularly wary of an internal rationale that the matter is complex and the other directors "just do not understand." If the director's view has been articulated clearly, concisely, and without animus or emotion, yet has failed to persuade fellow directors, it is likely that the other directors understand the matter but simply have drawn a different conclusion about the best course of action. The director also should consider whether the board's decision-making process is appropriately robust, including whether any conflicts have been disclosed and handled appropriately, and whether directors have the relevant information to be able to assess strategic options and come to an informed decision.

If the disagreement remains unresolved, the director has a range of possible responses, which will depend on the level of and reasons for the disagreement. For example, the director may (i) vote against the proposal and request that the dissent be recorded in the meeting minutes, (ii) seek to have the board reconsider or modify the decision, (iii) consider resigning, in a case of serious and continuing disagreement, where the director believes that their point of view is disregarded on a regular basis and therefore the director feels they cannot be effective in influencing board decisions, or (iv) seek legal advice about options if the director believes that significant issues of compliance or risk are not being addressed after raising the issues with the board. There are circumstances in which the courts look with disfavor on directors who resign rather than seek to address significant issues. For a public company, a disagreement concerning the company's operations, policies, or practices that results in a director's resignation or refusal to stand for re-election, if known about by an executive officer of the company, triggers a Form 8-K disclosure obligation.

Problematic Behavior

Problematic director behaviors come in a variety of forms, including:

- acting in an abrasive, abusive, or disrespectful manner
- monopolizing discussions
- unduly interfering in management operations
- overstepping one's authority
- failing to respect and abide by company protocols and policies
- leaking confidential information
- failing to disclose a conflict, acting on a conflicted basis, or both
- taking any action that breaches a fiduciary duty or violates a law or regulation

Boards have limited options to curb problematic director behaviors. Possible board responses include (i) informing, educating, and coaching a director, (ii) reprimanding a director, (iii) choosing not to re-nominate a director or requesting their resignation, (iv) forming a new board committee or removing a director from committees, and (v) removing a director.

Considerations in Setting Behavioral Norms

While diversity in director viewpoints should be highly valued and encouraged, and a range of director styles is to be expected, the board should establish behavioral norms for directors. These norms should set expectations about the behaviors that are valued and acceptable in board and committee discussions and in company-related interactions outside the boardroom. The governance committee and the board should periodically revisit these expectations, which can be reflected in the code of conduct for directors, corporate governance guidelines, or both.

Behavioral norms should be premised on a clear understanding of the roles of the board and management. Directors offer outside perspectives that can provide a stable foundation in times of tension and crisis, which is valuable in supporting effective governance. However, directors need to respect the limits of the board's role, which is focused on policy-setting and oversight, and avoid operating in the zone of management. To that end:

The board and management should agree on behavioral norms that support a clear delineation of board and management authority while recognizing that this line is difficult to draw and shifts based on the context.

- The board and management should agree on behavioral norms that support a clear delineation of board and management authority while recognizing that this line is difficult to draw and shifts based on the context.
- The CEO and independent board chair (or lead independent director) should agree on their respective roles and responsibilities, given the importance of mutual trust, respect, and candor between them. The board leader plays a key role in ensuring that the board has policies and practices that facilitate a healthy board culture.
- The board should agree on behavioral norms that respect the limits of individual director authority.

Practical Guidance

Trust and candor improve the board's ability to navigate challenging situations. Behavioral norms related to the flow of information and communications can help foster a culture where management is candid and shares negative news promptly, and directors are constructive and deliberative. Directors should be alerted about significant matters in a timely manner, including matters that implicate board responsibilities or may receive negative publicity. To that end:

- Directors should respect the impact that their requests may have on other work priorities and the interest that all directors have in access to the same base of information. The board should establish procedures for directors to suggest board meeting agenda items and identify information to be provided by management that would be helpful to both their understanding of the business generally and their consideration of specific matters.
- The board may wish to develop clear policies in consultation with management on how to coordinate meetings and other contacts with key employees to ensure that priorities are established and that directors have equal access to information.
- Given the highly confidential nature of information provided to directors and of the proceedings and deliberations of the board and its committees, directors should periodically be reminded not to share information outside the boardroom unless specifically authorized by the board.
- Behavioral norms should reflect the limited time available for board and committee meetings and the interest that all directors have in actively participating. Care should be taken to promote interaction and equal opportunity for participation.
- In communicating with one another outside board and committee meetings, directors should be mindful that the work of the board and its committees be undertaken through discussions in duly convened meetings. Email and text messaging among directors about substantive matters raise confidentiality and litigation risks, given their susceptibility to a security breach and their quick, informal tone and because they form an incomplete record. Substantive communication should take place in the security of a duly convened meeting in which all directors share the same base of information.

Periodic consideration of the behaviors expected of directors, the behaviors that are unacceptable, and the mechanisms for handling disagreements helps shape a positive board culture.

The following additional actions help to create a positive board culture and support appropriate director behaviors:

- discussing board culture and expectations about director conduct and reviewing related board policies periodically
- addressing behavioral norms in corporate governance guidelines or other appropriate board policies
- reminding directors of confidentiality requirements and other key policies periodically
- assessing board culture in the annual board evaluation
- underscoring expectations about director conduct in individual director evaluations
- considering a director's behavior in making re-nomination decisions
- discussing periodically in governance committee meetings and with counsel the avenues for addressing problematic behaviors
- addressing problematic behaviors when they arise

The board is responsible for developing an internal culture of trust, respect, and openness, and that culture is in large measure a product of accepted behaviors among directors. Periodic consideration of the behaviors expected of directors, the behaviors that are unacceptable, and the mechanisms for handling disagreements helps shape a positive board culture.

NEWS[13]

JUDICIAL DEVELOPMENTS

Board's Good-Faith Oversight of "Mission Critical" Risks Insulates Directors From *Caremark* Claim

In 1996, the Delaware Chancery Court issued its seminal decision in *In re Caremark International Inc. Derivative Litigation*, which establishes the framework for director oversight liability under Delaware law. Over time, Delaware courts frequently observed that this type of claim was "possibly the most difficult theory in corporation law upon which a plaintiff might hope to win a judgment,"[14] and these claims rarely advanced beyond the motion-to-dismiss stage. However, since 2019, Delaware courts have denied motions to dismiss *Caremark* claims in five cases, leading some to question whether the *Caremark* standard has been relaxed. A Chancery Court decision issued this summer provides an important counterpoint to this recent commentary while underscoring that boards must exercise rigorous oversight over "mission critical" risks.

The Delaware Chancery Court's decision in Hamrock *confirms that* Caremark *still requires a plaintiff to allege adequately that the board of directors engaged in bad faith and that this continues to be a difficult standard to satisfy—even when the case involves a "mission critical" risk.*

In *City of Detroit Police & Fire Retirement System, Inc. v. Hamrock* (Del. Ch. June 30, 2022),[15] Chancellor Kathaleen McCormick granted a motion to dismiss a stockholder derivative claim under *Caremark* for failure to plead demand futility. The case arose from a September 2018 natural gas overpressurization event in Massachusetts. NiSource, the nominal defendant in the stockholder derivative suit, owned a natural gas subsidiary called Columbia Gas of Massachusetts (CMA), which was involved in a construction project to replace old pipeline. An omission in the engineering plans led to the build-up of excess pressure in the system, which caused a series of fires and explosions. The damage from the incident ultimately led NiSource to report approximately $1 billion in losses. The National Transportation Safety Board investigated the incident. CMA was criminally prosecuted and entered into a plea agreement in February 2020, in which it pleaded guilty to one count of violating a federal gas pipeline safety regulation. NiSource entered into a deferred prosecution agreement.

As a precursor to the stockholder derivative litigation, a NiSource stockholder made a Section 220 demand for books and records, after which NiSource produced thousands of pages of books and records. Citing materials from the Section 220 production, and without first making a litigation demand on the board of directors, the stockholder filed a derivative suit against the board, initially in federal court and then again in the Chancery Court. (In the federal suit, the court dismissed with prejudice the plaintiff's federal claims but declined to reach the Delaware law claims on jurisdictional grounds.) In the Chancery Court, the defendant directors moved to dismiss, arguing that demand was not excused. The plaintiff's sole theory of demand futility was a *Caremark* theory.

Caremark requires a plaintiff to allege that directors acted in bad faith by (i) completely failing to implement any reporting or information system or controls or (ii) consciously failing to monitor or oversee a company's operations. The plaintiff in *Hamrock* argued that demand was futile because a majority of the board faced a substantial likelihood of personal liability because the directors purportedly consciously ignored "mission critical" compliance risks at NiSource's subsidiaries that would have alerted them to the risk of the September 2018 overpressurization event at CMA.

In a detailed 63-page opinion, Chancellor McCormick carefully analyzed the record and rejected the plaintiff's arguments. She held that the plaintiff failed to allege that a majority

13 The following Sidley lawyers contributed to the research and writing of the pieces in this section: Grigore Alexandru, Justin R. Becker, Lauri A. Bonacorsi, Rob R. Carlson, Neil H. Conrad, Jen Fernandez, Carys Golesworthy, Jarrett H. Gross, James Heyworth, Claire H. Holland, Eamon P. Joyce, Charles E. Mahone II, Vincent J. Margiotta, Marina R. Mehrtens, James Mendenhall, Richard Schneider III, Hille R. Sheppard, Heather Benzmiller Sultanian, Nilofer Umar, Marisa S. West, Nick Wiggins, and Caroline A. Wong. Some of the pieces first appeared in Sidley's Enhanced Scrutiny blog, which provides timely updates and thoughtful analysis on M&A and corporate governance matters from the Delaware courts and, on occasion, from other jurisdictions.

14 *Marchand v. Barnhill* (Del. Jun. 18, 2019).

15 The defendants in *Hamrock* were represented by Walter C. Carlson, Nilofer Umar, Neil H. Conrad, and Caroline A. Wong of Sidley Austin LLP.

of the board faced a substantial likelihood of liability under *Caremark*, and, therefore, demand on the board was not excused.

The opinion confirms that plaintiffs face a high hurdle when pursuing a claim under *Caremark*. Even with regard to "mission critical" risks, which require heightened oversight, plaintiffs can show demand futility only if they plead particularized facts establishing that the board "utterly failed" to put in place a reasonable system of monitoring and oversight. This standard is met only in rare circumstances, such as where a board leaves compliance entirely to management or receives reports on "mission critical" risks solely at management's discretion. The court held that this standard was not met in *Hamrock*. Among other things, the record demonstrated that the NiSource board and a board committee regularly monitored and discussed a variety of public safety matters, including gas pipeline safety matters. In fact, as the court observed, the Section 220 production showed that the board and committee "monitored and actively discussed" the specific pipeline regulatory risks that the plaintiff focused on in opposing the motion to dismiss. In rejecting the plaintiff's argument that these discussions occurred too infrequently, the court reiterated the familiar *Caremark* standard: "[T]his argument diverges too dramatically from the high 'utter failure' standard, even as understood through the refined lens of *Marchand* and *Boeing*. The bottom-line question that *Caremark* asks is whether the Board made a good faith effort to put in place a reasonable board-level system." NiSource had such a system in place, the court concluded.

In the face of detailed books and records produced by NiSource showing that its board and a board committee "monitored and actively discussed" public safety matters – including the specific pipeline regulatory risks at issue – the Delaware Chancery Court concluded that the plaintiffs failed to plead facts establishing that the board "utterly failed" to put in place a reasonable system of monitoring and overseeing risks.

The court also rejected the plaintiff's argument that the board ignored "red flags" of the September 2018 overpressurization event. In so doing, Chancellor McCormick articulated several key legal principles that shape Delaware courts' analysis of alleged "red flags" under *Caremark*. As the court explained, to serve as a basis for *Caremark* liability, (i) the board must have *known* about the alleged red flag before the corporate trauma at issue occurred; (ii) the alleged red flag must be "*sufficiently connected*" to the corporate trauma to put a reasonable observer on notice of the risk that gave rise to the corporate trauma; and (iii) the board must have acted with "*conscious disregard*" when confronted with the red flag. The plaintiff in *Hamrock* alleged a variety of putative red flags, each of which the court rejected for one or multiple reasons. For example, the court held that regulatory violations at one NiSource subsidiary were not a red flag of the overpressurization event at CMA because the incidents concerned "different employees, in a different state, in unrelated projects." As the court put it, the connection the plaintiff advanced was "too attenuated" to permit an inference of bad faith under *Caremark*. In another example, the court held that a management-level operational notice that addressed the importance of pressure-sensing lines for natural gas pipelines was not a red flag because the plaintiff failed to allege particularized facts indicating that the board was aware of the notice before the overpressurization event. More generally, the court closely reviewed the books and records on which the plaintiff purported to rely in evaluating whether those materials supported an inference that the board consciously disregarded a risk that led to the September 2018 overpressurization event. The detailed books and records that NiSource produced in response to the plaintiff's Section 220 demand, and that substantiated the NiSource board's good-faith exercise of oversight, were integral to the court's assessment.

As plaintiffs and defendants continue to spar over the significance of the recent Delaware cases that have allowed *Caremark* claims to proceed into discovery, *Hamrock* reflects a thorough and well-reasoned opinion confirming that *Caremark* still requires a plaintiff to allege adequately that the board of directors engaged in bad faith and that this continues to be a difficult standard to satisfy — even when the case involves a "mission critical" risk.

Delaware Court Reverses Dismissal of Post-Merger Claim That Directors Breached Fiduciary Duties in Order to Dissuade Stockholders From Exercising Appraisal Rights

In *In re GGP, Inc. S'holder Litig., No. 202, 2021* (Del. July 19, 2022), a split Delaware Supreme Court reversed the dismissal of a post-merger claim against directors of U.S. real estate company and mall operator, GGP, Inc. The court held that the stockholder plaintiffs adequately alleged that the director defendants breached their fiduciary duties by "consciously craft[ing] the transaction and the related disclosures in such a way as to deter GGP's stockholders from exercising their appraisal rights."

In 2017, the board of directors and special committee members of GGP (collectively, the director defendants) approved the sale of GGP to Brookfield Property Partners. One of the main points of contention during the merger negotiations involved Brookfield's insistence on an appraisal rights closing condition that would permit it to terminate the transaction if a specified number of GGP stockholders demanded a judicial or independent valuation of GGP's shares. GGP's special committee members opposed the inclusion of such provision and ultimately succeeded in excluding it. Instead, the parties finalized the merger agreement by dividing Brookfield's transaction consideration into two payments. GGP would first pay stockholders an automatic and significant "pre-closing dividend." This would be followed by a considerably smaller residual payment (~$0.31 per share) that the merger proxy statement defined as the "per share merger consideration." The transaction closed, and former GGP stockholders (collectively, the stockholder plaintiffs) brought suit. The Supreme Court reviewed two of the six claims dismissed by the Chancery Court.

In In re GGP, Inc. S'holder Litig.*, the Delaware Supreme Court reversed the Chancery Court's dismissal of a duty of disclosure claim after finding that GGP's merger proxy statement "described the merger and appraisal rights in a confusing manner" and "did not provide the stockholders the information they needed to decide whether to dissent and demand appraisal."*

In the first claim, the stockholder plaintiffs alleged that the director defendants intentionally designed the merger with a significant pre-closing dividend, constituting 98.5% of the deal consideration, to improperly "eviscerate the GGP stockholders' appraisal rights." The Supreme Court affirmed the dismissal of this claim. The court held that based on precedent and Section 262 of Delaware General Corporation Law (DGCL), dividends conditioned on the consummation of a merger are treated as merger consideration. The court further held that a "pre-closing dividend is merger consideration, not only for the purpose of triggering appraisal rights, but also for the purpose of framing the scope of the appraisal proceeding under Section 262." Had stockholders sought appraisal, GGP's fair value would be appraised as if the dividend had not been declared, with the per share consideration calculated to include both the pre-closing dividend and the consideration at closing.

In the second claim, the stockholder plaintiffs alleged that the director defendants breached their fiduciary duty of loyalty by intentionally failing to provide GGP stockholders material information relevant to appraisal rights. The Supreme Court reversed the Chancery Court's dismissal and analyzed the claim in light of two key issues:

1. whether the director defendants failed to provide material information
2. if so, whether they did so intentionally

Regarding the first question, the court described the proxy disclosures as "a deeply challenging read." Instead of using exact figures to define the transaction mechanics, the document broadly explained the structure of the two payments. The proxy then described the merger as occurring after the pre-closing dividend was declared and stated that stockholders were "entitled to exercise their appraisal rights solely in connection with the merger." This disclosure, in the court's view, was confusing because a properly conducted appraisal would have valued GGP before the payment of the pre-closing dividend. Additionally, the misleading information was material because there was a substantial likelihood that a reasonable stockholder would consider it important in deciding how to vote.

The court also found it reasonably conceivable that the director defendants intentionally violated their fiduciary duty of disclosure in order to dissuade class members from exercising appraisal rights because the agreement to bifurcate merger consideration came after

Brookfield had at least twice demanded and was denied an appraisal right closing condition. The director defendants also failed to identify an alternative justification for the transaction structure in their arguments for dismissal. For these reasons, the Supreme Court found that the stockholder plaintiffs met their burden. As a result, the court reversed the dismissal and remanded this second claim for further proceedings.

In light of this decision, companies should take note that for the purpose of DGCL Section 262 and appraisal rights, any pre-transaction dividend conditioned on a merger is considered merger consideration. In an appraisal proceeding, said dividend would be treated as if it had not been paid. Further, when describing the transaction structure in a proxy statement, in addition to following the requirements under DGCL Section 262, companies should describe the mechanics of the structure with enough detail and clarity to provide stockholders material information that could impact their decision to approve the transaction or reject it and seek appraisal.

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Key Learnings Regarding the Protectiveness of the *MFW* Process for Controlling Stockholder Transactions

The Delaware Chancery Court's recent decision in *City Pension Fund for Firefighters and Police Officers in the City of Miami v. The Trade Desk, Inc., et al.* (July 29, 2022), which granted the defendants' motion to dismiss, demonstrates how protective the *MFW* process of both an independent special committee of the board and a majority of the minority stockholder vote can be in a transaction with a controlling stockholder.

The *Trade Desk* decision addressed an amendment to The Trade Desk, Inc.'s certificate of incorporation that extended the duration of its dual-class stock structure to permit the company's co-founder and CEO to remain a controlling stockholder through high-vote Class B shares beyond the originally set dilution trigger. The plaintiff alleged that the absence of adequate consideration, among other things, rendered the transaction unfair. Because the controlling stockholder was personally interested in this transaction, the court ordinarily would review the transaction under the exacting entire fairness standard of review rather than under the deferential business judgment rule.

The Delaware Supreme Court in *Kahn v. M & F Worldwide Corp.*, 88 A.3d 635 (Del. 2014) (*MFW*), held that if the following process elements are all present, an interested transaction with a controlling stockholder will avoid entire fairness review and be reviewed instead under the business judgment rule:

1. The controller conditions the procession of the transaction on the approval of both a special committee and a majority of the minority stockholders.
2. The special committee is independent.
3. The special committee is empowered to freely select its own advisors and to say no definitively.
4. The special committee meets its duty of care in negotiating a fair price.
5. The vote of the minority is informed.
6. There is no coercion of the minority.

The Trade Desk board followed *MFW* by establishing a special committee of the board to negotiate the amendment with the controlling stockholder. In negotiating the amendment, the special committee extracted certain governance improvements—but no monetary consideration—for the company. The amendment was then put to a vote for approval by the minority stockholders and, following initial failures to obtain approval, ultimately was approved.

Because the Trade Desk board complied with the *MFW* process, the court did not "second guess[] the ultimate 'give' and 'get'" between the controlling stockholder and the company and limited its inquiry to a "process analysis." Concluding that the plaintiff failed to allege that any of the *MFW* process elements were deficient, the court granted the defendants' motion to dismiss the case.

A Majority Independent Special Committee Satisfied MFW

Importantly, the court held that the plaintiff had failed to allege that the special committee lacked independence because it did not allege facts impugning the independence of *a majority of* the directors on the special committee. The plaintiff meaningfully attacked the independence of only one of the directors on the special committee. The court held that even if the complaint adequately alleged that that director lacked independence, the special committee still satisfied *MFW* because the plaintiff had not adequately alleged that the other two directors lacked independence or that the allegedly beholden director dominated the process. The court stated that it was not expressly holding that a special committee need not be entirely independent in the *MFW* context, but noted that the plaintiff did not raise that argument. Nevertheless, *Trade Desk* supports respecting the special committee's conclusions, even if facts arise after the special committee is formed that shed some doubt on a particular member's independence, as long as a majority of the committee is independent.

Trade Desk *supports respecting the special committee's conclusions, even if facts arise after the special committee is formed that shed some doubt on a particular member's independence, as long as a majority of the committee is independent. Accordingly, boards may want to consider empaneling special committees of at least three directors where possible.*

Notably, if one member of the special committee may lack independence, a majority of the special committee can be independent only if the committee has at least three members. Boards may want to consider empaneling special committees of at least three directors where possible to take advantage of the possible application of the majority rule on independence.

Minority Stockholder Approval Obtained After Meeting Was Adjourned for the Company to Solicit Additional Votes Satisfied MFW

By the time of the December 7, 2020 special stockholder meeting held for Trade Desk stockholders to vote on the amendment to the certificate of incorporation, an insufficient number of stockholders had voted in favor of the amendment to secure majority of the minority approval. The company therefore adjourned the meeting and reconvened it on December 22, 2020, by which time it had mustered support and the amendment had been approved by 52% of the minority stockholders. In spite of the adjournment and the company's efforts to obtain additional minority votes in favor of the amendment, both of which were within the board's legal authority, the majority of the minority vote was held to satisfy *MFW*.

The court also held that the board was not required to disclose to the stockholders that it had actively sought the "yes" votes of significant Trade Desk stockholders because Delaware boards of directors have the authority to advocate for the actions they request of stockholders that they have deemed to be in the best interests of the company.

It is instructive that these general principles of law regarding stockholder voting were found to apply in *Trade Desk* to minority stockholder votes under *MFW* where the minority stockholder approval is particularly important in removing a transaction from heightened judicial review for entire fairness.

Delaware Courts Closely Examine Indemnification Claims for Attorneys' Fees, "Whether or Not" the Parties Intend

In *Samuel J. Heyman 1981 Continuing Tr. v. Ashland LLC* (Sep. 12, 2022),[16] the Delaware Supreme Court recently resolved a contractual dispute over potentially massive liability for cleaning up the Arthur Kill waterway in New Jersey. The contract at issue was a stock purchase agreement (SPA) in which Ashland LLC purchased 100% of the stock of an entity owned by a set of trusts affiliated with the Heyman family but then immediately transferred back a particular property in Linden, New Jersey, to another entity affiliated with the Heyman Parties. The Delaware Superior Court had granted summary judgment to Ashland on this issue, concluding that the relevant contractual provisions in the SPA (which used some fairly convoluted language to divide liabilities relating to that property) unambiguously allocated these environmental liabilities to the Heyman Parties—despite having earlier in the case determined the contract was ambiguous. On appeal, the Delaware Supreme Court determined that the contract was unambiguous in the other direction and clearly allocated all "offsite" environmental liabilities (including cleanup of the Arthur Kill waterway) to Ashland.

Although the court did not reach it in resolving this appeal, the case also raised another contractual interpretation issue of broad significance: the effect of an indemnification provision that allowed a party to recover "reasonable attorneys' fees and consultants' fees and expenses[], whether or not involving a Third Party Claim." Ashland argued that this "whether or not" language clearly and unequivocally covered attorneys' fees incurred in first-party litigation and sought to recover its fees from litigating the contractual dispute. Recent Delaware precedent casts substantial doubt on such interpretations. Last year, the Delaware Supreme Court affirmed a Chancery Court decision rejecting a party's request for first-party litigation fee-shifting under nearly identical language. The Chancery Court explained that the "whether or not" language should not be interpreted as "a backhanded way of saying 'including legal fees incurred in first party claims'" because "sophisticated parties, negotiating at arms-length, would [not] have chosen the phrase 'whether or not arising out of third party claims' to explicitly state that this provision was meant to shift fees in disputes between the parties." The Chancery Court's interpretation was bolstered by another provision of the contract, in which the parties had explicitly permitted fee-shifting for attorneys' fees in first-party litigation, but only under narrow circumstances. The inclusion of a "clear and unequivocal articulation of an intent to shift fees" elsewhere in the same agreement "[u]nderscore[d]" that the parties did not intend for the general indemnification provision to also shift first-party litigation fees more broadly.

Indemnification provisions should be drafted to unmistakably, and in plain English, demonstrate an intent to shift fees to the prevailing party in first-party litigation.

In high-stakes contractual disputes, attorneys' fees can be substantial. Recovery of those fees often becomes a high priority, falling closely behind winning the case itself. But the groundwork for a successful claim for fee-shifting must be laid in advance, well before any dispute has arisen. Recent Delaware precedent, and the issues raised though not decided in the recent *Heyman* appeal, are a reminder that if an indemnification provision is intended to include first-party litigation fees, it should not be drafted to invoke those fees by implication or inference. Instead, indemnification provisions should be drafted to unmistakably, and in plain English, demonstrate an intent to shift fees to the prevailing party in first-party litigation.

16 The appellants in *Heyman* were represented by Robert N. Hochman, Eamon P. Joyce and Heather Benzmiller Sultanian of Sidley Austin LLP.

Combatting Allegations of "Divided Loyalty": Important Lessons for Private Equity and Venture Capital Controlling Stockholders

Recently, the Delaware Chancery Court issued another ruling regarding the sale of Authentix Acquisition Company, Inc. to Blue Water Energy LLP, which was approved in 2017 by Authentix's board of directors and its controlling stockholders. *Manti Holdings, LLC v. Carlyle Group Inc.*, C.A. No. 2020-0657-SG, 2022 WL 1815759 (Del. Ch. June 3, 2022). The court denied in part a motion to dismiss and held that the gravamen of the plaintiffs' post-closing money damages complaint—allegations that the defendants breached fiduciary duties regarding the sale—sufficiently stated claims upon which relief could be granted. The ruling underscores the need for heightened care by target companies and their equity sponsors when contemplating a transaction supported by an equity sponsor, including in their communications (or lack of communications) with management and other stockholders.

In 2015, Authentix's board began to explore a potential sale of the company, which provides authentication solutions for governments, central banks, and commercial products. Plaintiffs alleged that three of the board's five members, including Authentix's CEO, were affiliated with Authentix's controlling stockholders (collectively, the Sponsor) and that the Sponsor encouraged them to push through a sale of Authentix, even if such transaction was unfavorable to common stockholders.

In June 2017, the board voted, over the objection of a director affiliated with one of the plaintiff stockholders, to proceed with a sale to Blue Water. Blue Water submitted an offer of $77.5 million in guaranteed consideration, all payable at closing, with an additional $27.5 million payable after closing if certain receivables were timely paid and if Authentix met certain financial metrics the following year. The plaintiff-affiliated director disapproved of a sale at the time, due to prior estimates from financial advisors that the value of the company would be greater if certain customer contracts (for which plaintiffs alleged renewal had been uncertain throughout the sale process) were successfully renewed. Thereafter, according to plaintiffs, the other Authentix directors stopped providing him updates on the sale process. In August 2017, Authentix successfully renewed two key customer contracts. According to plaintiffs, the board directed the company to continue with Blue Water negotiations, notwithstanding the company's favorable change in value as a result of the contract renewals.

A group of minority stockholder plaintiffs brought an action in the Chancery Court, alleging the Sponsor-affiliated directors and the controlling Sponsor breached fiduciary duties to Authentix stockholders by approving the sale to Blue Water for less-than-favorable consideration. In a memorandum opinion, Vice Chancellor Sam Glasscock III concluded that the entire fairness standard of review applied to the sale and that the Sponsor and director defendants must demonstrate fair dealing and fair price with respect thereto. The court explained:

> Delaware Courts have identified two categories of conflicted controller transactions that implicate the entire fairness standard: (a) transactions where the controller stands on both sides; and (b) transactions where the controller competes with the common stockholders for consideration…Under the second category, a controller competes with common stockholders for consideration when it (i) receives greater monetary consideration for its shares than the minority stockholders, (ii) takes a different form of consideration than the minority stockholders, or (iii) extracts something uniquely valuable to the controller, even if the controller nominally receives the same consideration as all other stockholders.

Assuming plaintiffs' allegations as true for the purposes of the defendants' motion, the court concluded that it was reasonably conceivable that the Sponsor received a "unique benefit" from the sale because pursuant to the company's capital structure and the terms of a stockholders' agreement, preferred stockholders were entitled to receive the first $70 million of the $77.5 million in guaranteed sale consideration before common stockholders were entitled to receive anything. The court further credited the plaintiffs' allegations that (i) uncertainties regarding the renewal of key customer contracts, which informed sale negotiations, had been resolved shortly before the board approved the sale, but the board did not revisit the terms of the anticipated sale or reengage other prospective bidders following this development; (ii) the Sponsor encouraged the directors to facilitate a sale for the benefit of the Sponsor; (iii) three of the target company's five directors were either affiliated with or not completely independent of the Sponsor; and (iv) the board ceased to keep the plaintiff-affiliated director apprised of the sale process during the final stage of negotiations, after he expressed disapproval of the contemplated transaction. The court also concluded that the three director defendants in question could not be presumed to have acted independently of the Sponsor's interests.

The Manti *decision serves as a reminder to target boards exploring a sale of a private equity or venture capital-controlled entity of their obligation to conduct board business and processes with sufficient formalities to lessen the risk of a contested dispute.*

The *Manti* decision provides an occasion for reminding target boards exploring a sale of a private equity or venture capital-controlled entity of their obligation to conduct board business and processes with sufficient formalities to lessen the risk of a contested dispute. The Chancery Court relied heavily on plaintiffs' allegations regarding discussions among the Sponsor-affiliated directors, which were not held during formal board meetings, as well as the alleged exclusion of the dissident director from board discussions concerning the sale process. Such allegations, accepted as true at the pleadings stage, gave rise to colorable fiduciary duty and unjust enrichment claims against the defendants.

Of course, target boards should always consider the interests of all equity stockholders when examining the efficacy of a significant transaction. To insulate legitimate board conduct from "he said, she said" allegations—which, in connection with other allegations, might give rise to a reasonably conceivable fiduciary claim—board business should, to the extent possible, occur in formal meetings, with proper notice being given to all directors, and be memorialized in minutes that reflect clearly what was discussed, including comprehensive reflections regarding the decision-making process. Side discussions, like those alleged in *Manti*, should be avoided to the extent possible.

Moreover, it is prudent for target boards to utilize, when appropriate, an independent special committee to analyze a prospective transaction, particularly where sponsor appointees or other affiliates serve in board or senior management roles. As the Chancery Court explained in *Manti*, "[u]nder the great weight of Delaware precedent, senior corporate officers generally lack independence for purposes of evaluating matters that implicate the interests of a controller." For more details, see the *Enhanced Scrutiny* blog post on the *Manti* decision available here.

LEGISLATIVE DEVELOPMENTS

DGCL Amendment Allows Delaware Corporations to Amend Charters to Exculpate Officers From Personal Liability

Under Delaware law, directors and officers owe fiduciary duties of care and loyalty: to act in good faith with the care that an ordinarily prudent person would exercise in like circumstances and in a manner the director or officer reasonably believes to be in the best interest of the company and its stockholders. Section 102(b)(7) of the DGCL was amended effective August 1, 2022 to allow a Delaware corporation to adopt an exculpatory provision in its charter that eliminates or limits the personal liability of specified executive officers for monetary liability for breaches of the duty of care. Previously only directors could benefit from this protection. Unlike for directors, the newly amended DGCL Section 102(b)(7) does not eliminate or limit the personal liability of officers for breaches of the duty of care arising out of claims brought by the corporation or derivative claims brought by stockholders on behalf of the corporation.

DGCL Section 102(b)(7) was amended effective August 1, 2022 to allow a Delaware corporation to adopt an exculpatory provision in its charter that eliminates or limits the personal liability of specified executive officers for monetary liability for breaches of the duty of care. Delaware corporations should consider seeking stockholder approval for officer exculpation charter amendments at their 2023 annual meetings.

Covered officers eligible for exculpation from personal liability under amended DGCL Section 102(b)(7) are:

- the president, chief executive officer, chief financial officer, chief operating officer, chief legal officer, controller, treasurer, or chief accounting officer
- the corporation's most highly compensated executive officers as identified in SEC filings
- certain other officers who have consented (or deemed to have consented) to be identified as an officer and to service of process

New Delaware corporations should include an exculpatory provision in their charter that applies to both directors and officers. Existing Delaware corporations must amend their charters to implement the officer exculpatory provision, which will require both board and stockholder approval. The protection is not retroactive, and the exculpatory provision will apply only with respect to acts and omissions while it is in effect.

Many public companies are waiting to see how proxy advisors and institutional investors will react to amended DGCL Section 102(b)(7) before deciding whether to seek stockholder approval of officer exculpation charter amendments at their 2023 annual meetings. In the coming months, Delaware corporations should be on the lookout for any new policy guidance published by ISS and Glass Lewis and engage with their institutional investors on this topic.

SEC DEVELOPMENTS

New SEC Comment Letter Initiative Seeks More Tailored Disclosures About Board Leadership Structure and Role in Risk Oversight

Through the new comment letter initiative, the SEC is not creating new disclosure requirements or trying to influence how companies operate—it merely wants companies to commit to providing more robust and tailored disclosures about board leadership structure and board risk oversight in future filings.

The SEC's Division of Corporation Finance recently launched a new comment letter initiative urging targeted public companies to enhance their disclosures about the board's leadership structure and role in risk oversight. The review by the Division Staff is being broadly applied across all public companies and is not focused on any particular industry or board leadership structure. According to SEC representatives, the reason for the initiative is that the Division Staff have noticed that the disclosure required by Item 407(h) of Regulation S-K has become increasingly standardized rather than tailored to a company's individual circumstances. Disclosure should provide investors with insights about why a company has chosen its particular board leadership structure (regardless of the type of leadership structure selected) or how a company's board is discharging its risk oversight responsibilities in light of the specific challenges facing its business.

Item 407(h) requires a public company to briefly describe its board leadership structure, such as whether the same person serves as both chief executive officer and chair or whether two individuals serve in those positions. If the same person serves in both positions, a company must disclose whether it has a lead independent director and the specific role that person plays in leadership of the board. The disclosure should specify why the company has determined that its leadership structure is appropriate given its specific characteristics or circumstances. Finally, Item 407(h) requires a public company to disclose the extent of the board's role in risk oversight, such as how the board administers its oversight function and the effect that this has on the board's leadership structure.

Because the text of Item 407(h) is relatively less prescriptive than other SEC disclosure requirements, the Division Staff direct companies to the 2009 adopting release for guidance. In that release, the SEC notes that "different leadership structures may be suitable for different companies depending on factors such as the size of a company, the nature of a company's business, or internal control considerations, among other things." With respect to the board risk oversight disclosure requirement, that release notes that such disclosure "might address questions such as whether the persons who oversee risk management report directly to the board as whole, to a committee, such as the audit committee, or to one of the other standing committees of the board; and whether and how the board, or board committee, monitors risk."

The Division Staff are not seeking to review revised disclosures now but merely a commitment by companies to enhance their Item 407(h) disclosures in future filings. Public companies should ensure that their 2023 proxy statement disclosures on board leadership structure and board risk oversight are sufficiently comprehensive and tailored to their individual circumstances.

Final SEC Pay-Versus-Performance Rule Will Require Extensive New Disclosures in 2023 Proxy Statements

On August 25, 2022, the SEC adopted a long-awaited final rule requiring certain public companies to disclose information relating to the relationship between executive compensation actually paid by the company and the company's financial performance. This new disclosure rule implements Section 953(a) of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, which added Section 14(i) to the Securities Exchange Act of 1934, as amended (Exchange Act).

The new pay-versus-performance rules are complex, and the timeline to comply with the disclosure requirements is compressed. Companies should coordinate with advisors (e.g., accountants, compensation consultants, compensation committees) and start compiling the required information now to be ready to make the required disclosures in their 2023 proxy statements.

Section 14(i) of the Exchange Act adds Item 402(v) of Regulation S-K, which requires companies to provide, in any proxy or information statement in which executive compensation is required to be disclosed under Item 402 of Regulation S-K, a table in a specified format disclosing for each of the past five completed fiscal years executive compensation (summary compensation table reported and compensation actually paid) for each individual serving as the company's principal executive officer (PEO) during each year covered by the table as well as the average executive compensation (summary compensation table reported and compensation actually paid) for the company's named executive officers (NEOs) other than the PEO, the cumulative total shareholder return (TSR) for the company and a selected peer group, the company's net income, and a company-selected measure of performance that, in the company's assessment, represents the most important performance measure used by the company to link compensation actually paid during the most recently completed fiscal year to company performance (Company-Selected Measure). Following the table, companies will also be required to describe the relationship between each of the company's performance measures and the compensation actually paid to its NEOs and to compare the company's cumulative TSR to the cumulative TSR of the selected peer group.

In addition to the new Pay-Versus-Performance Table, companies will be required to disclose a table listing at least three, and no more than seven, of the most important performance measures used by the company to link executive compensation actually paid for the most recently completed fiscal year to company performance. See the Sidley Update available here for a more detailed summary of the new disclosure rule.

Companies must begin to comply with the new disclosure requirements under Item 402(v) in proxy and information statements that are required to include Regulation S-K Item 402 disclosure for fiscal years ending on or after December 16, 2022, which for calendar-year-end companies will be the 2023 annual meeting proxy statement. As a result, most public companies will be required to include the pay-versus-performance disclosure in their proxy statements during the 2023 proxy season.

Although some of the data to be disclosed in the Pay-Versus-Performance Table (and its footnotes) can be derived from information currently reported under existing disclosure requirements, companies should consider the need to implement any additional processes to support the new disclosures, including retesting the probability of achievement of performance-based awards on a year-end basis. Companies should begin evaluating what they deem to be the most important performance measures used to determine executive compensation and whether to provide any voluntary disclosure to supplement the required pay-versus-performance disclosure. Companies should also consider discussing the new disclosure requirements and their implications with their compensation committees and, specifically, the additional compensation measures that will be included in the disclosure.

REGULATORY DEVELOPMENTS

Executive Order Directs CFIUS to Conduct Broad National Security Analysis When Evaluating Transactions

On September 15, 2022, President Joe Biden signed Executive Order 14083 (EO 14083), which provides guidance on how the Committee on Foreign Investment in the United States (CFIUS) and transaction parties should examine national security risks associated with any given transaction. EO 14083 does not change the scope of CFIUS jurisdiction, impose new or different mandatory filing requirements, or break new ground on how CFIUS can or should conduct its examinations. EO 14083 is instead significant in highlighting particular points of emphasis. The general theme of EO 14083 is that CFIUS should not examine transactions in isolation but should instead consider individual transactions in the context of broader trends; broader policy concerns regarding the protections of supply chains, technology, and data; and the interrelationships of the foreign investor with foreign third parties.

President Biden's recent executive order directs that CFIUS should not examine transactions in isolation but should instead consider individual transactions in the context of broader trends; broader policy concerns regarding the protections of supply chains, technology, and data; and the interrelationships of the foreign investor with foreign third parties.

The EO 14083 background press call is linked here, a White House fact sheet summarizing EO 14083 is linked here, and Treasury Secretary Janet Yellen's statement is linked here. The primary takeaways from EO 14083 are as follows:

- *The Importance of the U.S. Business to U.S. Supply Chains Will Be a Critical Consideration for CFIUS.* The U.S. government is intensely focused on protecting the health and resiliency of its supply chains and domestic manufacturing capacity, including, but not limited to supply chains that are part of the defense industrial base, which consists of more than 100,000 defense companies and their subcontractors. EO 14083 emphasizes the importance of U.S. supply chains that are fundamental to national security, including those relating to sensitive technologies, critical minerals, food, and energy. While these areas of sensitivity are not new, EO 14083 sends a clear message to parties that CFIUS will consider investments in these areas to be potential vulnerabilities that it will want to review.
- *The List of Sensitive Technologies Will Continue to Grow.* Existing CFIUS regulations emphasize the sensitivity of "critical technologies," which essentially are technologies that are subject to export control restrictions under the Export Administration Regulations, the International Traffic in Arms Regulations, and other regulatory regimes dealing with, for instance, select agents and toxins, or nuclear-related equipment and materials. Those technologies will remain sensitive, and the new EO does not modify the definition of critical technologies or the scope of mandatory CFIUS filing requirements in connection with investments in businesses that develop or manufacture such technologies. However, EO 14083 identifies the following sectors as "fundamental to national security": microelectronics, artificial intelligence, biotechnology and biomanufacturing, quantum computing, advanced clean energy (such as battery storage and hydrogen), climate adaptation technologies, critical materials (such as lithium and rare earth elements), and "elements of the agriculture industrial base that have implications for food security." EO 14083 directs the Office of Science and Technology Policy to periodically publish a list of sensitive technology sectors. When foreign investors invest in U.S. companies that develop or manufacture such technologies, they should expect that CFIUS will take a particular interest in the transaction.

- *Economic Context Is Important.* EO 14083 directs CFIUS to consider transactions in the context of broader investment trends. CFIUS will consider whether the foreign investor may be making incremental acquisitions that in the aggregate could provide the foreign investor access to important technologies. CFIUS will also consider, for example, the foreign investor's aggregate presence in U.S. supply chains or in sensitive sectors. In furtherance of this policy, CFIUS may request that the Department of Commerce International Trade Administration analyze investment trends in a given sector or industry.[17] As a result, when submitting CFIUS filings, it would be prudent for parties to explain how their transaction fits within the context of broader industry trends.
- *Cybersecurity Risks Remain a Priority.* EO 14083 directs CFIUS to focus on cybersecurity risks and whether the U.S. business that is the target of an investment presents vulnerabilities that could be exploited, for example, to affect the outcome of elections, disrupt critical infrastructure or the health and resiliency of the defense industrial base, or compromise communications.
- *Parties Should Understand When and How Anonymized Personal Data Can Be De-Anonymized.* Current CFIUS regulations identify several categories of "identifiable" personal data that are deemed to be particularly sensitive. If a U.S. business collects or maintains such data, then (depending on the nature and quantity of such data) foreign investments in such businesses may result in expanded CFIUS jurisdiction and, in some cases involving foreign government-invested entities, mandatory filings. The regulations treat data as identifiable data "if any party to the transaction has, or as a result of the transaction will have, the ability to disaggregate or de-anonymize the data, or if the data is otherwise capable of being used to distinguish or trace an individual's identity." EO 14083 emphasizes that "advances in technology, combined with access to large data sets, increasingly enable the re-identification or de-anonymization of what once was unidentifiable data." Parties should therefore expect that CFIUS will consider whether access to data sets that might appear anonymized can, in fact, be de-anonymized when combined with other information or technologies that might be available to the foreign investor.
- *Be Cognizant of Third-Party Ties.* EO 14083 emphasizes the importance of considering a transaction party's "relevant third-party ties," that is, ties to "foreign persons, including foreign governments, to whom the foreign person has commercial, investment, non-economic, or other ties (relevant third-party ties) that might cause the transaction to pose an elevated threat to national security." CFIUS is directed to examine risks that might arise from, for example, transferring manufacturing capabilities to such third parties, sharing technology or personal data with such parties, the involvement of such third parties in supply chains, incremental or multiple investments by such third parties in technologies or supply chains, or access of such third parties to databases or systems that present cybersecurity threats to databases of personal information.

EO 14083 provides helpful insight into how CFIUS will conduct its examination of individual transactions and how parties should frame their arguments to CFIUS.

Much of the guidance in EO 14083 is not new. The general concepts are familiar and unsurprising. However, EO 14083 provides helpful insight into how CFIUS will conduct its examination of individual transactions and how parties should frame their arguments to CFIUS. That analysis should not focus on the transaction in isolation but should instead place the transaction in the context of broader industry, economic, and policy trends.

For years, CFIUS has required parties to address certain standard questions related to, for example, the commercial rationale for a transaction, the target's market share, the target's cybersecurity policy, and the like. Oftentimes, parties have provided brief, summary responses to such questions. In light of EO 14083, those questions may assume greater importance and may require greater attention and focus when preparing future CFIUS filings.

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17 Note that, while EO 14083 does not discuss the BE-13 Survey of New Foreign Direct Investment in the United States that the Department of Commerce, Bureau of Economic Analysis conducts, it is possible that there will be an increased focus on reaching out to U.S. companies to comply with requirements to submit Form BE-13 filings in connection with new foreign investments. That information may be helpful in assessing overall investment trends.

Making Sense of DOJ's New Monaco Memo on Corporate Enforcement

In September 2022, the U.S. DOJ Deputy Attorney General (DAG), Lisa Monaco, issued a 15-page memo discussing revisions to DOJ's heavily scrutinized Corporate Enforcement Policy. The September 15 release of the Monaco Memo was accompanied by a speech the same day by DAG Monaco and a speech the next day by the head of the DOJ Criminal Division, Assistant Attorney General Kenneth Polite.

While the Monaco Memo does not make large-scale, concrete changes to the fundamentals of DOJ's Corporate Enforcement Policy, the memo and accompanying speeches provide important insights into how corporations can expect the current DOJ leadership to analyze some of the key concepts in federal corporate enforcement. And in some discrete areas, the Monaco Memo breaks new ground with detailed DOJ guidance.

The immediate reporting on DAG Monaco's speech and the Monaco Memo tended to highlight her statements that DOJ would no longer engage in "business as usual" regarding its investigations of corporations and corporate officials and that DOJ was now instituting its first-ever "department-wide policies" on some areas.

The reality is more nuanced. A close look at the Monaco Memo in the context of DOJ's existing Corporate Enforcement Policy shows that the changes to DOJ's policies are on discrete topics, but some of these changes signal that DOJ is implementing a substantial shift toward a more aggressive approach in corporate crime matters—especially in terms of DOJ's expectations for the pace of corporate internal investigations and related disclosures to DOJ. The memo and accompanying speeches also provide important insights into how corporations can expect DOJ to analyze some of the key concepts in federal corporate enforcement, including "cooperation credit" and "voluntary self-disclosure." And in some areas, the Monaco Memo breaks new ground with detailed DOJ guidance. The areas include the following, each of which is described in detail in the Sidley Update available here:

1. cooperation credit and the "timely" disclosure of information learned in internal investigations
2. clarifying (in the future) the benefits of voluntary self-disclosure
3. clarifying (in the future) how to earn maximum cooperation credit
4. DOJ scrutiny of discrete corporate policies—including executive compensation policies—in assessing compliance programs
5. delaying corporate resolutions until DOJ's investigation of individuals is completed
6. guidance for corporations with prior misconduct resolutions (criminal and non-criminal)
7. documents located abroad
8. new guidelines for independent corporate monitor process

With respect to 4. above, the memo emphasized that DOJ will regularly examine a company's policies relating to compensation arrangements to determine whether they incentivize "compliance-promoting behavior." The memo's carrot-and-stick approach asks whether a company has put in place both incentives for such behavior (including performance reviews that "measure and reward" positive compliance actions) and penalties for employees whose actions contributed to criminal conduct (such as clawback provisions or partial escrowing of compensation). The memo issued high-level guidance for now and stated that DOJ will develop further guidance by the end of 2022, which we will address in a future issue of *Sidley Perspectives*.

About 20 months into the Biden administration, the Monaco Memo reflects DOJ's desire to make faster progress in corporate crime investigations and to show greater results, in part by pushing corporate internal investigations to move quicker and disclose more information earlier. The memo also does more nuts-and-bolts work—attempting to create detailed policies on numerous discrete issues that have received substantial attention, and to refine and clarify several central corporate enforcement issues with a promise of more detailed guidance to come. Staying attuned to these new statements will help corporations involved in DOJ investigations make smart decisions about how to proceed—both internally and with DOJ.

SIDLEY RESOURCES

Shareholder Activism

SEC Proposes Amendments to the Substantial Implementation, Duplication, and Resubmission Bases for Excluding Shareholder Proposals (July 18, 2022). In July, the SEC proposed rule amendments that would update certain substantive bases for exclusion of shareholder proposals under the SEC's shareholder proposal rule, Exchange Act Rule 14a-8. The proposed amendments would revise three of the substantive bases for exclusion: the "substantial implementation" exclusion in Rule 14a-8(i)(10), the "duplication" exclusion in Rule 14a-8(i)(11), and the "resubmission" exclusion in Rule 14a-8(i)(12). The proposed amendments would provide the following:

- A proposal may be excluded as substantially implemented if "the company has already implemented the essential elements of the proposal."
- A proposal "substantially duplicates" another proposal if it "addresses the same subject matter and seeks the same objective by the same means."
- A proposal constitutes a resubmission if it "substantially duplicates" a prior proposal, using the same test proposed in the previous bullet.

The SEC accepted public comments on the proposed rules through September 12, 2022.

ISS Provides Guidance on the Universal Proxy Card, Puts "Weakest" Directors on Notice (Aug. 24, 2022). On August 22, 2022, ISS, the leading global proxy advisory firm, issued a special situations research note on the new, mandatory universal proxy card rules instituted by the SEC. In its note, ISS declared the new rules the "superior" way for shareholders to exercise their voting franchise and observed that this system will make it "dramatically easier" and "cheap" for activist shareholders to launch proxy fights. ISS also offered perspectives on how the new system could help activists in their campaigns. Public companies should pay close attention to these perspectives in light of the weighty influence of ISS's proxy voting recommendations on the outcomes of contested director elections. The most notable of ISS's perspectives are that under the new framework, directors' individual qualifications may come into greater focus relative to the merits of an overall slate and that a board's "weakest" members may now become more vulnerable in a proxy contest.

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Universal Proxy Card Resource Center (Aug. 31, 2022). The SEC's adoption of new rules mandating the use of universal proxy cards is a monumental change for shareholder activism and public company corporate governance. Sidley recently launched the Universal Proxy Card Resource Center as a one-stop resource featuring a collection of rules, commentary, and other relevant information to educate market participants and help them navigate the evolving landscape.

Corporate Governance

The Future of the American Board: A Framework for Governing into the Future (Sep. 2022). The National Association of Corporate Directors (NACD) recently released the report of its Commission on the Future of the American Board, entitled *A Framework for Governing into the Future*. Sidley partner Holly Gregory served as the Special Advisor to the Commission throughout the development of the report. By outlining ten principles to build toward higher board performance in the coming years, the report is designed to help guide boards into the future, position them to become better stewards of long-term value creation for all stakeholders, and meet broadening expectations at a time when business is being called on to address an increasing number of challenges facing the nation and the planet.

Best Practices for Auto Boards During Industry Revolution (Aug. 9, 2022). In this article for *Law360*, Sidley partners Ike Adams and Justin Savage discuss best practices for boards of directors of companies in the automotive industry to consider to withstand regulatory scrutiny and mitigate risks. For example, as regulators in the U.S. and European Union (EU) continue to ratchet up the pressure on climate change goals and ESG, boards need to be extra careful about their companies' commitments to going carbon neutral and the efficacy of electric vehicles. That means putting clear plans and metrics in place to ensure appropriate follow-through and effective communications with investors so that they are well informed about the caveats, risks, and limitations.

How a company determines when and when not to speak out on sensitive issues will vary, and there is considerable risk that some key constituents will be offended in any event.

Speaking Out On What Matters (Sep. 2022). In this article for *Ethical Boardroom*, Sidley partner Holly Gregory discusses the increased pressure faced by companies to engage more publicly on sensitive issues, including issues that have varying degrees of relationship to the company's business. How a company determines when and when not to speak out on sensitive issues will vary, and there is considerable risk that some key constituents will be offended in any event. Because failure to take a position may expose a company to significant criticism and risk, the strategy of avoidance may not be as available as it was in the past. What is key is that the decision to speak out or not is consistent with the company's interests and values.

Crisis Management

Collaborative Crisis Management: Prepare, Execute, Recover, Repeat (Sep. 2022). In this new book published by the University of Chicago Press, Sidley Senior Counsel Tom Cole and Paul Verbinnen, Co-Chairman of North America at FGS Global, provide a thorough and approachable guide to successful crisis management from anticipation to resolution and a primer on how organizational leadership should prepare for and handle crises. The steps, plans, and cautions they offer show how organizations can deal openly and honestly with challenges while continuing to survive and prosper.

ESG

EU Corporate Sustainability Reporting Directive — What Do UK- and U.S.- Headquartered Companies Need to Know? (Aug. 2, 2022). Non-EU companies with a significant presence in the EU or with securities listed on a EU-regulated market will become subject to new EU rules on corporate sustainability disclosures (the Corporate Sustainability Reporting Directive, or CSRD) that will be phased in from 2024. The EU rules differ in scope and content from recent proposals for climate-related disclosures from the SEC in the U.S. The EU rules also go beyond the UK's current climate-focused disclosure requirements for large UK companies and for London Stock Exchange-listed issuers. This Sidley Update explores the implications of CSRD for companies with headquarters outside the EU, including the scope of application of CSRD and the content of its disclosure requirements.

How the Supreme Court's EPA Ruling Complicates Climate Action and What Companies Can Do (Aug. 30, 2022). The U.S. Supreme Court's recent decision in *West Virginia v. EPA* clips the ability of the Environmental Protection Agency to address climate change and may fundamentally alter the administrative authority of other federal agencies to tackle big problems. As state and local governments find ways to fill the void, shareholders are demanding a response from corporate America. How seismic is the ruling? Will it doom our efforts to address climate change? And what impact will the enactment of the Inflation Reduction Act have on the ruling? In the latest episode of *The Sidley Podcast*, host Sam Gandhi speaks with Sidley partners Justin Savage and Simone Jones about how the *West Virginia v. EPA* ruling complicates climate action — and what companies can do now. Listen to the episode here and view the transcript here.

U.S. Major Questions Doctrine Could Affect Rulemakings at the FTC and SEC (Sep. 21, 2022). The U.S. Supreme Court's decision in *West Virginia v. EPA*, which reinvigorated the major questions doctrine, could affect upcoming rulemakings related to privacy and cybersecurity at the FTC and SEC. In the FTC's recent Advance Notice of Proposed Rulemaking on "Trade Regulation Rule on Commercial Surveillance and Data Security," concerns relating to the major questions doctrine have already been raised. The doctrine is likely to create increased regulatory uncertainty with respect to rulemakings outside of an agency's traditional lane, as is the case with many privacy and cybersecurity issues, and we can expect further litigation challenging agency rulemaking on this basis.

Sidley lawyers Holly J. Gregory, Leonard Wood, and Rebecca Grapsas recently wrote the U.S. chapter in the 2023 edition of *Getting the Deal Through—ESG & Impact Investing*. The comparative summary addresses various ESG topics, including impact investing, purpose-driven companies, impact measurement standards, policies and tax incentives, and recent trends.

Corporate Compliance Programs

New DOJ Compliance Chief Signals Increased Compliance Program Scrutiny (Sep. 12, 2022). A new expert on corporate compliance programs is joining the Fraud Section of the DOJ, bringing a wealth of compliance experience that will be used to scrutinize (and, where appropriate, criticize) the compliance programs of companies under DOJ investigation. The announcement of DOJ's return to a centralized compliance resource—and one with years of compliance experience at a company that had been subject to a Foreign Corrupt Practices Act investigation and enforcement action—should serve as a signal to companies to prioritize (and enhance) their compliance programs to avoid government investigations and be able to defend their compliance programs in front of DOJ's new expert should they become subject to a government investigation.

Antitrust

Sidley Antitrust Bulletin: Our Take on Top-of-Mind Global Antitrust Issues (Sep. 28, 2022). The Sidley Antitrust Bulletin provides thoughts on topics that are top-of-mind for Sidley's Antitrust team as of September 2022 and why they matter to our clients. Discussions around the U.S. antitrust agencies' review and intervention in mergers and acquisitions continue. The new FTC Democratic majority has been busy, issuing its five-year strategic plan, three broad omnibus resolutions authorizing staff to issue compulsory process more easily, and a policy statement discouraging the use of certificates of public advantage to sidestep hospital merger review. Looking to the courts, the European Commission (EC) recently succeeded in dismissing an appeal of one of its prohibition decisions under the EU Merger Regulation, arguably lowering the standard of proof required by the EC to prohibit transactions. The UK's Competition Appeal Tribunal set aside a 2020 decision by the Competition and Markets Authority related to most favored nation clauses, which may cause some tension in light of the UK's new Vertical Agreements Block Exemption Order. And in the U.S., the DOJ amicus brief program is going strong.

Sidley Antitrust Bulletin: Our Take on Top-of-Mind Global Antitrust Issues (Aug. 8, 2022). In terms of topics that were top-of-mind for Sidley's Antitrust team as of August 2022, Assistant Attorney General Jonathan Kanter of the DOJ reiterated his intention to litigate and block mergers rather than settle with merging parties, and the DOJ also has set its sights on private equity acquisitions. Tim Wu, a Special Assistant to President Joe Biden, has suggested that the agencies should not be afraid of seeking to break up consummated mergers. Across the Atlantic, recent rulings in the UK and from the General Court in Luxembourg found procedural irregularities during the authorities' investigations.

Cybersecurity

'Cyclops Blink' Shows Why the SEC's Proposed Cybersecurity Disclosure Rule Could Undermine the Nation's Cybersecurity (Aug. 30, 2022). In this article for *Lawfare*, Sidley partner Alan Charles Raul and Sidley associates Steve McInerney and Sasha Hondagneu-Messner caution that the SEC's proposed cybersecurity disclosure rule could undermine the nation's cybersecurity. As nation-state actors increase their malicious cyber capabilities toward companies, U.S. regulators such as the SEC have understandably increased their

regulatory focus on cybersecurity. The SEC is of course a well-intended member of Team Cyber, and investors in public companies might benefit from some aspects of the SEC's proposal: Increased knowledge of a company's cybersecurity risks, experience, governance, and resiliency could be important to their decision-making. But the proposal is dangerous to the extent that it jeopardizes important safety, security, and geopolitical interests in the name of disclosure. Put simply, the SEC's proposal must be revised to assure responsible (not reckless) public disclosure. The SEC should not force public companies to choose between SEC liability and effective collaboration with the government's cybersecurity-focused agencies. As is, the proposed rule could increase the risk to the U.S.'s critical infrastructure, economy, homeland, and allies. The proposal should include deference for exigent law enforcement, national security, and judicial needs and allow delay where appropriate for ongoing, unpatched incidents when premature disclosure could harm a broad swath of vulnerable companies and even government agencies.

Tax

New 15% Corporate Minimum Tax: Short Summary and Potential Impact on Mergers and Acquisitions (Aug. 15, 2022). On August 12, 2022, the U.S. Congress passed the Inflation Reduction Act of 2022, which imposes a new 15% corporate minimum tax on certain large corporations (the Corporate AMT). President Joe Biden signed the Act into law on August 16, 2022. As described in this Sidley Update, corporations subject to this new law will need to give significant consideration to the Corporate AMT, including assessing its application in connection with various M&A transactions.

New 1% Excise Tax on Stock Repurchases by Publicly Traded Corporations (Aug. 15, 2022). The Inflation Reduction Act of 2022 (signed into law in August) includes a new 1% excise tax on stock repurchases by certain publicly traded corporations. As described in this Sidley Update, the statute's broad scope could cover many transactions beyond typical stock buyback plans, including certain redemptions of privately held preferred stock, special purpose acquisition company transactions, and leveraged take-private acquisitions.

Miscellaneous

To Bond or Not to Bond: Enforceability of Contractual Waivers of Bond Requirements for Injunctive Relief (Aug. 18, 2022). Parties to commercial agreements often include provisions that seek to remove or limit potential roadblocks to injunctive relief in the event of a breach. This Sidley Update warns that drafters of agreements subject to Delaware law should be aware that the Chancery Court may not enforce contractual waivers of bond requirements if considerations of equity weigh in favor of requiring a bond.

SIDLEY EVENTS

Sidley Corporate College

October 19-20 | Virtual and In Person in Chicago and New York

Sidley will host its annual Corporate College program on October 19-20. Sidley's Corporate College is a two-day training program intended to expose participants to a broad spectrum of topics that a transactional lawyer is likely to encounter. Presentation topics will include M&A, private equity, shareholder activism, capital markets, corporate governance, SEC enforcement, bank financing, tax, antitrust, and executive compensation considerations in M&A transactions, and ethics. In-house lawyers of all levels may benefit from the program. Anyone interested in attending virtually or in person in Chicago or New York should contact chevents@sidley.com.

SIDLEY SPEAKERS

2022 Proxy Disclosure & 19th Annual Executive Compensation Conferences

October 12-14 | Virtual

Sonia Gupta Barros, a partner in Sidley's Washington, D.C. office, will participate in a panel titled *The SEC All-Stars: Proxy Season Insights* on October 12 at the 2022 Proxy Disclosure & 19th Annual Executive Compensation Conferences presented by TheCorporateCounsel.net and CompensationStandards.com. Click here for more information.

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