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ANALYSIS

EARNINGS PRE-RELEASE CONSIDERATIONS

By Paul Choi, Jim Ducayet, Beth Berg, and Helen Jazzar¹

When deciding whether to pre-release earnings, companies should assess the implications of pre-releasing from both a practical and legal perspective.

Although not required by U.S. Securities and Exchange Commission (SEC) rules or stock exchange listing standards, publicly traded companies typically issue earnings press releases and hold earnings calls with investors and analysts each quarter to satisfy market demand for financial information shortly before filing periodic SEC reports on Form 10-Q and Form 10-K. Some companies limit the content of the quarterly earnings release and earnings call to historical financial results, while others choose to provide earnings guidance or projections. In this article, for convenience of reference, “guidance” or “projections” refers to forward-looking financial information regarding a company’s expected future financial or operating results.

Companies may choose to “pre-release” or “pre-announce” expected quarterly financial results prior to a regularly scheduled earnings release even though they are typically not legally required to do so. Pre-releasing earnings is a form of voluntary disclosure typically used in situations where a company anticipates earnings to differ materially from the expectations of investors or analysts or from guidance the company previously issued.²

Considerations to take into account when deciding whether to pre-release earnings include the following:

1. *Whether a Pre-Release is Legally Required.* Absent unusual circumstances, a company is under no obligation to update guidance or projections in “real time,” and the caselaw on whether there is a duty to correct guidance or projections (as opposed to historical information) is murky at best. As a general rule, however, any duty to disclose information prior to a periodic SEC filing is likely to depend on whether the information to be updated lacked a subjective good faith basis or was objectively unreasonable. The greater the difference between actual results and those contemplated by the guidance or projections—and the shorter the timeframe between the last public statement of the guidance or projection and when the company determines that it will miss such guidance or projection—the more likely it is that a plaintiff or a regulator will argue that the guidance or projection was incorrect when made and that there was therefore a duty to correct.
2. *Credibility With Investors and Analysts.* Investors and analysts do not want to be blindsided. Even though earnings releases include disclaimers explaining that projections are subject to potential risks that could cause actual results to differ materially from those projected at the time, a significant miss may nevertheless undermine hard-won credibility. A pre-release may avoid some of this credibility hit by showing investors that the company is being transparent with them and ensuring that they are apprised of significant adverse developments even before the company would otherwise be required to disclose them.

Pre-releasing earnings is a form of voluntary disclosure typically used in situations where a company anticipates earnings to differ materially from the expectations of investors or analysts or from guidance the company previously issued.

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² This article does not address other contexts in which a public company may choose to pre-release earnings, such as in advance of a pending capital markets transaction.

When faced with the decision regarding a potential pre-release, companies would be well advised to work closely with their external legal advisors, public relations, and investor relations professionals and accountants.

3. *Confidence in the Accuracy of the Pre-Release.* If a company has determined to pre-release its results, it should do so only when management is highly confident in the accuracy of the numbers, or at least a relatively narrow range. Having to make more than one pre-release, or ultimately reporting final financial results that materially differ from those reported in the pre-release, may backfire and end up harming rather than helping the company's credibility with investors and analysts. When preparing the pre-release, companies should ensure that no material information is omitted that might render the disclosure materially misleading or inaccurate.
4. *Litigation and Risk Management.* Although difficult (if not impossible) to test empirically, many believe that a pre-release may reduce market reaction to negative developments when compared to waiting until the company's normal periodic disclosure. Whether or not that is true, there is at least some benefit to a pre-release because it will reduce the size of the potential class of plaintiffs that can bring litigation in connection with any stock price decline that results.
5. *Compliance With Regulation FD.* Information regarding a potential earnings miss is, of course, likely to be highly material, and no one who is aware of it should trade in the company's stock. In addition, nonpublic interactions with investors and analysts while in possession of this information creates a risk of selective disclosure. Some companies have adopted "quiet periods" in the days and weeks leading up to the quarterly earnings release, which may help avoid putting the company and its representatives in awkward circumstances. A pre-release can also address that risk, and it may be preferable to canceling participation in investor conferences or other investor meetings, if there is a concern that an abrupt cancellation would prompt damaging speculation and rumors. If such participation or meetings do proceed prior to the public release, company representatives will need to be well prepared regarding how to ensure they remain in compliance with Regulation FD, including by answering difficult questions about the company's current and anticipated financial performance. In that regard, because analysts can be finely attuned to variations in how company executives answer questions, note that a "non-answer" or "no comment" may itself signal something is amiss if the typical practice has been to respond to such questions.
6. *Potential Litigation.* Pre-releases of negative earnings performance, like all negative disclosures, will likely draw attention from the plaintiff's securities bar, and the basis for the information contained in the pre-release could be scrutinized in litigation. As such, it is important to ensure that the underlying facts and circumstances leading to the disclosure, as well as the text of the disclosure itself, are reviewed by an experienced securities litigator.
7. *Precedential Effect.* Pre-releasing earnings may create an expectation that a company will do so in the future under similar circumstances, which could limit the company's perceived options in the future when it is faced with a comparable situation.
8. *Cross-Functional Support.* Lastly, determining whether to issue a pre-release is not a decision that should be made in a silo. Generally, the parties involved should include the company's chief executive officer, chief financial officer, chief legal officer, investor relations head and key members of the board (such as the audit committee). External legal counsel is often involved, including litigators who can advise on how to reduce potential liability. Any pre-release should be reviewed by the disclosure committee (if any) and outside auditors. The company should also provide the New York Stock Exchange (NYSE) or Nasdaq, as applicable, with advance notice of the pre-release.

Whether to pre-release financial results involves many legal, investor relations, and practical considerations, including those discussed above. When faced with the decision regarding a potential pre-release, companies would be well advised to work closely with their external legal advisors, public relations, and investor relations professionals and accountants.

UPDATE ON THE FIRST PROXY CAMPAIGN SEASON WITH UNIVERSAL PROXY CARDS

By Kai H.E. Liekefett, Derek Zaba, and Eric S. Goodwin³

As we approach the one-year anniversary of the mandatory use of universal proxy cards in contested director elections, it is clear that many expectations about activism have been challenged by this new regime. Whether changing how shareholders vote for directors will affect voting decisions, election outcomes, settlement dynamics, campaign tactics, or even the types of activist shareholders has been hotly debated among market participants. While there have been fewer public activist campaigns this season than many expected, they have revealed several trends that we discuss in this article.

A universal proxy card allows shareholders to vote for any combination of validly nominated director candidates on a single proxy card, regardless of whether the candidate was nominated by the board of directors or a dissident shareholder. Use of the universal proxy card by companies and dissidents is now mandatory for contested director elections under Rule 14a-19 under the Securities Exchange Act of 1934, which was adopted by the SEC in November 2021. Prior to the adoption of Rule 14a-19, shareholders could not practically vote for their preferred mix of director candidates from the company's slate and the dissident's competing slate.

We wish to emphasize that the trends discussed in this article are only initial observations of a rapidly evolving environment. Concluded proxy contests in the universal proxy card era are currently a small sample size, and market participants are responding to the lessons learned from each campaign. Going forward, we expect the dynamics of proxy campaigns to remain in flux for several years.

The Salience of Making the Case for Change

Even though activist campaigns often involve a proxy contest for the election of directors, shareholder activism has traditionally been understood as a contest between competing visions about the past, present, and future of the targeted company. Proxy contests have historically been viewed as an extraordinary intervention by shareholders to change corporate policy, and dissidents have been required to prove the superiority of their thesis for the company to prevail over the incumbent board at an election.

Perhaps the most critical question arising from the introduction of the universal proxy card is whether its candidate-based voting mechanic will transform activism campaigns from contests over competing visions into solely a contest over board composition. In an extreme case, proxy contests could become normalized into a kind of "external nominating committee" for the selection of the most qualified directors—minimizing, if not entirely disregarding, the merits of an activist's case for change.

Whether proxy contests continue to hinge on the activist's case for change has profound import for companies and shareholders. If proxy contests become a referendum on director qualifications, activists can target almost any company with a highly credible threat of beating the weakest incumbent candidates—even if the activist has not presented a credible thesis about corporate performance. This shift would dramatically expand the universe of companies vulnerable to activism and increase activists' leverage over companies in settlement negotiations. Conversely, retaining an emphasis on strategic, operational, and governance issues ensures that activist campaigns continue to turn on the primary drivers of shareholder value. It empowers shareholders to evaluate whether the activist has advanced a superior competing vision for the company and, if so, to support that vision in the director election.

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The principal impact of the universal proxy card so far appears to be a better calibration between the level of change proven by the activist and the number of activist candidates supported.

ISS and Glass Lewis have stated that they will continue to demand that activists advance a compelling case for change as the threshold issue in making voting recommendations, focusing on director qualifications only if they have determined that the activist has met this burden. Large institutional investors, such as BlackRock and State Street, have similarly said that they will approach voting under the universal proxy card regime similarly to the way in which they have approached contested elections in the past. However, due to the limited number of contested elections since the introduction of the universal proxy card, it is not yet clear whether proxy advisors and institutional investors have remained consistent with past practice or have instead shifted their voting frameworks.

What is clear is that candidate quality has become more important to voting recommendations and decisions. We are seeing companies and activists enhance their descriptions of nominee skills and experience, and proxy advisors have been weighing individual candidate qualifications once the activist has proven that board change is critical to enhance corporate performance. We also expect that candidate quality will have greater salience in campaigns with stark differences in candidate quality and those where the company and activist have each advanced strong strategic and operational arguments. But even in the universal proxy card era, neither companies nor activists are likely to prevail solely because they have compiled a strong candidate slate.

Unfortunately, we have begun seeing activist-side advisors arguing that proxy advisors and institutional investors should focus solely on the qualifications of the competing directors. Jeff Smith of Starboard Value LP recently made this argument when addressing the Council of Institutional Investors, where he criticized ISS and Glass Lewis for sticking with the requirement that the activist prove a case for change and encouraged shareholders to ignore their voting recommendations. We expect activists to continue to seek a redefinition of proxy contests away from the contest between ideas towards the contest over people.

Calibration to the Proven Level of Change

The principal impact of the universal proxy card so far appears to be a better calibration between the level of change proven by the activist and the number of activist candidates supported. In the past, voting for a partial activist slate meant that the shareholder could not vote for management directors opposed by the activist. These unused votes could lead to the election of more activist nominees than the shareholder supported. By contrast, a universal proxy card enables shareholders to vote for the precise mix of candidates they support.

For instance, in our view, ISS recommendations have appeared to “split the baby” between activist and company slates at an uncommonly high rate this year. In several of these situations, ISS determined that the activist had proven a case for change but acknowledged that the boards were composed of highly qualified directors with relevant skill sets. In some cases, ISS reasoned that adding a partial activist slate would increase the board’s credibility or increase pressure on management and incumbent directors. These recommendations suggest that activists will be unable to achieve significant influence on a board merely because they have proven that some level of change is desirable.

In the universal proxy card era, the directors who are the least vulnerable to an activist will not only be qualified individually but will also be additive to the company's current and near-term strategy in a differentiated way not represented by other directors.

Advance Notice Provisions Remain Essential

Several activists this year have been unable to take advantage of the universal proxy card rules because they failed to abide by companies' advance notice provisions in their submission of director candidates. In recent [Compliance & Disclosure Interpretations](#), the SEC confirmed that companies may omit activist candidates who have not been validly nominated from their proxy cards. However, companies should be aware that if a court subsequently overturns the board's rejection of an activist's nominations, the company must furnish universal proxy cards that include the activist's nominees to its shareholders, discard previously furnished proxy cards, and give shareholders sufficient time to receive and cast their votes on the new proxy cards (which may require adjourning or postponing the shareholder meeting).

We are also seeing companies adopt advance notice provisions intended to ensure that activists comply with the scant obligations created by the universal proxy card rules. For instance, a typical provision requires the activist to provide evidence to the company that it has solicited two-thirds of shareholders in accordance with the rules; nominations by an activist who has not complied with the rules are disregarded under these provisions. These provisions limit the risk that activists will exploit the universal proxy card rules to put their candidates on the company's proxy card without also complying with the rules' obligations.

Next Steps for Boards

The universal proxy card rule ushers in another stage of activism's evolution. In response, we believe boards should take certain steps to help ensure that the universal proxy card does not result in an unfair advantage to activists seeking to exploit the dynamics created by the new rule.

- *Boards should regularly evaluate their composition in light of the company's strategic and operational priorities.* Many have observed that the switch to a candidate-based voting system means that directors with long tenure, advanced age, or other individual vulnerabilities are more likely to be targeted by activists and less likely to be supported by proxy advisors and institutional investors. While this is potentially true, companies should not evaluate director qualifications in isolation. In the universal proxy card era, the directors who are the least vulnerable to an activist will not only be qualified individually but will also be additive to the company's current and near-term strategy in a differentiated way not represented by other directors.
- *Companies should evaluate their vulnerabilities to activism and take action to address strategic, operational, and governance vulnerabilities.* It has become increasingly common for companies to "be their own activist" and regularly evaluate potential strategic, operational, and governance enhancements. Any such enhancements reduce the risk of being targeted and increase success if an activist appears.
- *Companies should regularly review their structural defenses, including advance notice bylaws, to ensure that they reflect market best practices.* Structural defenses are intended to enhance the board's ability to assess and respond to an activist or other hostile party. In particular, advance notice provisions are the best way to ensure that the company and its shareholders learn about the activists' and their candidates' relationships, backgrounds, and other pertinent topics.

CORPORATE OFFICERS' ROLE IN CORPORATE GOVERNANCE: WHAT OFFICERS NEED TO KNOW

By Beth Berg, Hannah Ellis, and John Howard⁴

The recent Delaware Chancery Court decision *In re McDonald's Corporate Stockholder Derivative Litigation* is a reminder of corporate officer duties and the vital role that corporate officers play in corporate governance at both publicly and privately held corporations. These duties stem from officers' status as both agents and fiduciaries. For boards of directors and other officers to perform their roles effectively, it is critical for officers to understand and satisfy their duties. Failure to do so may deprive boards of directors of information they need to monitor operations, mitigate risks, and establish strategy and can expose officers to personal liability.

Duties as Agents

As agents, officers are obligated to keep their principals (i.e., superior officers or the board) informed of material information relevant to their roles as officers. This encompasses not only information officers actually know, but also information they *have reason* to know or *should* know that would be necessary for the board in its monitoring and decision-making functions. The board must rely on officers for information because officers are close to day-to-day management and thus have access to the information necessary for boards to analyze and act on critical issues. If an officer fails to gather and to, directly or indirectly, provide material information to the board, the officer could face personal liability.

Duties as Officers

For many years, Delaware courts have been clear that both officers and directors owe fiduciary duties of care and loyalty. In broad terms, the duty of care is the obligation to consider all material information that is reasonably available and to act on an informed basis with the degree of care of an ordinarily prudent person in a like position under similar circumstances. The duty of loyalty is the obligation to act in a disinterested basis, in good faith and in a manner honestly believed to be in the corporation's best interests.

There can be severe consequences for breaching these duties. For example, if an officer breaches the duty of loyalty, the officer may face personal liability for monetary damages. Damages awarded for these breaches typically cannot be satisfied through indemnification by the corporation because officers are generally not entitled to indemnification unless they act in a manner that they reasonably believe to be in the best interest of the corporation. Although corporations can buy insurance to protect directors and officers from losses when indemnification is unavailable, many policies will not cover intentionally dishonest conduct, fraud, or willful violations of law.

Officers may be surprised by what could be considered a breach of the duty of loyalty. Fraud and criminal conduct are obvious breaches. However, any activity designed to further a personal interest such as sharing confidential information or trade secrets, embezzlement, engaging in sexual harassment, or breaching non-solicitation agreements may constitute a breach of the duty of loyalty because the actions are at odds with the corporation's best interests.

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Consider providing officer training covering officer fiduciary duties and officer responsibilities as agents of the corporation, including real-world scenarios and Q&As to help officers understand their duties in practice.

A component of the fiduciary duty of loyalty is the duty of oversight. As confirmed in the *McDonald's* case, a breach of this duty would occur if an officer (1) fails to make a good-faith effort to implement a reporting or information system designed to provide the officer with the information necessary to perform such officer's job or (2) consciously fails to monitor such a reporting or information system or consciously ignores red flags emerging from such a system. The decision makes clear that as day-to-day managers, officers are an essential link in the corporate oversight structure.

Unlike directors, who have "plenary authority" over the business and affairs of a corporation, the extent of an officer's oversight duty depends on the officer's area of responsibility. Officers generally will be responsible for addressing or reporting "red flags" within their areas of responsibility. However, there may be some signals that are sufficiently prominent that any officer might have a duty to report it upward. This serves to prevent officers from turning a blind eye and dismissing glaring issues as "not in their area."

Action Items for Corporations

- Consider providing officer training covering officer fiduciary duties and officer responsibilities as agents of the corporation.
 - Include real-world scenarios and Q&As to help officers understand their duties in practice.
 - Ensure that officers know when and how to report up regarding "red flags."
- Because officers' duty of oversight is context-driven, ensure that roles and responsibilities are clearly defined and understood, both by the board and by management.
- Consider whether the processes for developing board materials is sufficiently robust to cover major areas of potential risk and which officers should regularly report to the board.
- Ensure that board materials and minutes reflect that the board has been informed of potential risks, how they are addressed, and which officers are responsible.
- If permitted under applicable law (as in Delaware since 2022), consider amending the corporate charter to provide for officer exculpation.

Action Items for Officers

- When acting as a corporate officer, prioritize the corporation and its interests over your own desires and preferences.
- Remember that the board's reputation is in your hands.
- Make sure you help the board understand the business and the context of risk and opportunities.
- Supply timely information that is accurate, complete, and understandable. Always put yourself in the directors' shoes in assessing the information flow and, for any information provided to the board, have a firm understanding of its purpose.
- Help ensure that the board is never surprised (by good or bad news).
- Make sure you have asked yourself the tough questions before the board does.
- Embrace process (including documentation).
- Consider ways to standardize the creation and distribution of information to improve quality and save time.
- If you have any questions about reporting to the board or regarding your duties or responsibilities as a corporate officer, ask your General Counsel.

NEWS⁵

JUDICIAL DEVELOPMENTS

Delaware Chancery Court Further Defines the Contours of What Constitutes a Sale of “Substantially All” Assets

In a recent [decision](#), Chancellor Kathaleen McCormick of the Delaware Chancery Court examined what constitutes a sale of “substantially all” of a selling company’s assets for purposes of Section 271 of the Delaware General Corporation Law (DGCL), granting a company’s motion to dismiss a stockholder’s lawsuit alleging that a sale of the “crown jewel” of the company amounted to a sale of substantially all of its assets and accordingly required stockholder approval. *Altieri v. Alexy*, No. 2021-0946-KSJM (Del. Ch. May 22, 2023).

On June 2, 2021, cybersecurity company Mandiant, Inc. sold its FireEye business line that developed products to detect and prevent cyberattacks for \$1.2 billion. Although Mandiant retained existing business lines focused on providing services to respond to cyberattacks, assess cybersecurity risks, and perform security automation, the FireEye business had accounted for 62% and 57% of Mandiant’s overall revenue in 2019 and 2020, respectively, and constituted approximately 38% of its total assets. Mandiant’s board approved the sale but did not seek stockholder approval, and the company’s stock price dropped by 17.62% following the sale announcement. One of Mandiant’s stockholders sued the company and its board to void the sale, primarily claiming that it was a sale of “all or substantially all” of Mandiant’s assets and therefore required stockholder approval under DGCL Section 271.

The court analyzed this claim under the *Gimbel* test, which requires an evaluation of the quantitative and qualitative importance of the subject transaction to determine whether it “struck at the heart of the corporate existence and purpose” in that it involved the “destruction of the means to accomplish the purpose or objects for which the corporation was incorporated and actually performs.”⁶ It ultimately determined that the sale in question did not meet either prong of the test.

Examining first the quantitative aspects of the sale, the court held that it did not support a conclusion that Mandiant had sold substantially all of its assets. The court advised that when evaluating quantitative metrics, “no one factor is necessarily dispositive” among the various data points courts consider (e.g., revenue generated by the assets sold as a percentage of total company revenue; the percentage of book value of the sale; the contribution of the assets sold to the company’s overall EBITDA; and future earnings potential) and there is no necessary quantifying percentage. Even though the sale was for \$1.2 billion, the FireEye business comprised only approximately 38% of Mandiant’s total assets, which the court held “[fell] short of the substantially-all threshold from a quantitative perspective.” The court distinguished the sale from prior cases in which the *Gimbel* test had been met on quantitative grounds because each of the prior cases involved a sale of a company’s sole or primary income-producing asset that itself comprised 68% to 75% of that company’s total assets. The court also contrasted the sale at issue with the prior cases because it found that the stockholder had not “pled facts indicating that Mandiant is unable to generate income in FireEye’s absence.”

Next, the court assessed the qualitative factors of the sale. Although acknowledging that Mandiant’s sale of the FireEye business was “out of the ordinary” and “may alter course in how [Mandiant] operates,” the court followed the same line of reasoning in *Hollinger* to hold that the *Gimbel* test was still not met because the change to Mandiant’s corporate existence

⁵ The following Sidley lawyers contributed to the research and writing of the pieces in this section: Grigore Alexandru, Jaime A. Bartlett, Tyler Baylis, Justin R. Becker, Sara B. Brody, Stephen Chang, Matthew J. Dolan, Jen Fernandez, Chaddy Georges, Carys Golesworthy, Claire H. Holland, Thomas E. Johnson, Ross O. Kloeber IV, Jennifer H. Lee, Kai H.E. Liekefett, Vincent J. Margiotta, James Mendenhall, Hille R. Sheppard, and Andrew W. Stern. 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.

⁶ *Gimbel v. Signal Companies, Inc.*, 316 A.2d 599, 606 (Del. Ch. 1974).

According to the Delaware Chancery Court in Altieri, with respect to the court's qualitative analysis, the sale of a business line that may alter the course of a company's operations or that is viewed as the "crown jewel" of its overall business will still not be deemed a sale of substantially all of the company's assets so long as the company's historic line of business remains largely intact.

and purpose was not so qualitatively significant as to "strike a blow" to Mandiant's core business as a cybersecurity firm.⁷ The court distinguished prior cases in which a sale had satisfied the *Gimbel* test primarily due to qualitative factors because Mandiant's sale "did not represent a stark departure from [Mandiant's] historic line of business." Mandiant was at its core a cybersecurity company before the sale, and it remained a cybersecurity company with several existing business lines after the sale. Following the reasoning of *Hollinger*, the court concluded that Mandiant's investors were still left with an investment in a cybersecurity company after the sale of the FireEye business, even assuming it had been the "crown jewel" of Mandiant's overall business at the time of the sale.

A key takeaway from the quantitative analysis in this decision is the court's emphasis on the ratio of assets being sold as compared to the overall assets of the business. Even though the FireEye business was responsible for a significant majority of Mandiant's overall revenue, it consisted of only about one-third of Mandiant's overall assets. In the absence of facts to indicate that Mandiant could not generate income without the FireEye business, the percentage of assets being sold was dispositive to the court's determination on the quantitative prong of the *Gimbel* test. With respect to the court's qualitative analysis, a significant takeaway is that the sale of a business line that may alter the course of a company's operations or that is viewed as the "crown jewel" of its overall business will still not be deemed a sale of substantially all of the company's assets so long as the company's historic line of business remains largely intact. *Altieri*, therefore, effectively narrows the circumstances in which stockholders of a Delaware corporation may have approval rights to a sale under DGCL Section 271.

The Forum Selection Saga Continues: Part II

On June 1, 2023, the majority of an *en banc* panel of the U.S. Court of Appeals for the Ninth Circuit found that Gap Inc.'s forum selection clause does not violate the anti-waiver provision of the Securities Exchange Act of 1934 or Delaware law, entrenching its split with the Seventh Circuit's circuit ruling on the same questions and ensuring that the enforcement of forum selection clauses across jurisdictions will remain unsettled for the foreseeable future. [Lee v. Fisher](#), No. 21-15923.

The appellant, Noelle Lee, filed a derivative suit in federal court against Gap in September 2020, alleging that Gap failed to meet its publicly stated goal of creating greater racial and ethnic diversity in the company's board and executive management. The Northern District of California dismissed the suit, finding that Gap's bylaws contain a forum selection clause requiring derivative claims to be filed in the Delaware Chancery Court.

On appeal, Lee argued that enforcing Gap's forum selection clause would usurp federal jurisdiction over Exchange Act claims and violate the Supremacy Clause. Lee further argued that the Delaware Chancery Court could not grant relief for the type of claim raised, allowing corporations to avoid liability by using such forum selection clauses to their advantage. The Ninth Circuit upheld the district court's decision on May 13, 2022.

The Ninth Circuit's holding created a circuit split with the Seventh Circuit's ruling in *Seafarers Pension Plan v. Bradway*, 23 F.4th 714 (7th Cir. 2022), where that court held that Boeing's same forum selection clause violated the Exchange Act's anti-waiver provision and DGCL Section 115.

As discussed in our [December 2022 issue](#) of *Sidley Perspectives*, in light of the circuit split, the Ninth Circuit granted the request for an *en banc* rehearing, and argument was held in December 2022.

⁷ *Hollinger Inc. v. Hollinger Int'l, Inc.*, 858 A.2d 342, 379 (Del. Ch. 2004).

With the circuit split on both the impact under Delaware law of Section 115 following Salzberg and the availability of Section 14(a) as a sufficient means for shareholders to directly enforce the Exchange Act in a federal forum, the forum selection saga is now certain to continue for the foreseeable future.

A focus of argument on rehearing (and a concern noted in public commentary) was whether enforcement of the forum selection clause would enable companies to escape federal enforcement of the Exchange Act. The court rejected that notion, holding that because stockholders like Lee can enforce compliance with the Exchange Act through a direct action brought in federal court, the forum selection clause does not infringe on the federal jurisdiction granted under the act. In so holding, the court noted that Lee's alleged injury was not dependent on harm to the corporation, thus opening a door for direct action under Section 14(a).

Next, the Ninth Circuit found that Gap's forum selection clause does not contravene public policy under *M/S Bremen v. Zapata Off-Shore Co.*, 407 U.S. 1 (1972). Lee's argument relied heavily on *J.I. Case Co. v. Borak*, 377 U.S. 426, 432 (1964), claiming that Borak established a private right of action for a stockholder to bring a federal cause of action for redress of injury caused by a proxy statement. The Ninth Circuit found Borak to be less persuasive, stating that *Borak* held that a stockholder could bring a direct action under Section 14(a). But the court concluded that the *Borak* ruling inappropriately extended its reasoning to derivative suits, stating that "[e]ven at the time *Borak* was decided, [the Court's reasoning] did not square with the Supreme Court's jurisprudence regarding derivative actions. Nor did *Borak* attempt to harmonize its statements on derivative actions with the Court's precedent." The Ninth Circuit concluded that *Borak* failed to consider the role of state law in governing the scope of corporate conduct and that the Supreme Court had shifted away from implying private rights of action. Noting jurisprudential evolution since *Borak*, the Ninth Circuit found that Gap's forum selection clause does not meet the extraordinary circumstance of violating a strong public policy in favor of federal jurisdiction for derivative actions.

Last, the Ninth Circuit concluded that Gap's forum selection clause is not contrary to Delaware law and, in so holding, affirmed its split with the Seventh Circuit in *Seafarers*. DGCL Section 115 states that bylaws "may require...that any or all internal corporate claims shall be brought solely and exclusively in any or all of the courts of this State." The court found that Lee (and thus the Seventh Circuit) misinterpreted Delaware law in arguing that Section 115 precludes a forum selection clause from requiring a federal claim (such as one under Section 14(a)) to be brought in state court where that court would have to dismiss the claim for lack of jurisdiction. To the contrary, the Ninth Circuit held that Section 115 is silent, and thus inapplicable, to forum selection clauses addressing federal claims. Section 115 speaks only on "internal corporate claims," which the Ninth Circuit found to mean claims arising under the DGCL. Acknowledging its divergence from the Seventh Circuit's analysis in *Seafarers*, the court opined that *Seafarers* failed to consider and apply the reasoning of *Salzberg v. Sciabacucchi*, 227 A.3d 102, 117 (Del. 2020), and failed to recognize the availability to shareholders of a direct action under Section 14(a).

With the circuit split on both the impact under Delaware law of Section 115 following Salzberg and the availability of Section 14(a) as a sufficient means for shareholders to directly enforce the Exchange Act in a federal forum, the forum selection saga is now certain to continue for the foreseeable future. Stay tuned...

The Delaware Chancery Court clarified in Edgio that Corwin cleansing does not apply to post-close claims for injunctive relief.

Delaware Chancery Court Cancels *Corwin* for Post-Close Claims for Injunctive Relief

In May 2023, Vice Chancellor Morgan T. Zurn of the Delaware Chancery Court issued a [decision](#) regarding an unsettled question of Delaware corporate law: whether an uncoerced and fully informed vote of disinterested stockholders may ratify and defeat a post-close claim seeking to enjoin certain governance measures and alleged entrenchment devices negotiated by a company's board as part of a transaction. *In re Edgio, Inc. S'holders Litig.* (Del. Ch. May 1, 2023). The court concluded that such a vote, known commonly as "Corwin cleansing," does not apply to post-close claims for injunctive relief under *Unocal Corp. v. Mesa Petroleum Co.* The court's decision, at least for now, will have immediate significance for company boards and their advisors when negotiating transactions or stockholder agreements that include measures that may be characterized as defensive or entrenching existing management or directors.

Limelight Network, Inc., a public company that provides network service for digital media content and software, had missed its earnings forecasts and underperformed relative to analysts' estimates since July 2020, when its stock had reached an all-time high. Despite efforts to turn around the business, Limelight's performance continued to slide, and market commentators speculated that Limelight might be targeted by activist investors.

In 2022, Limelight entered into a stock-for-stock transaction with the owners of Edgecast, Inc. to create Edgio, Inc. The purchase agreement contemplated Limelight's issuance of \$300 million of its stock—a 35% ownership stake—to College Parent, L.P., Edgecast's parent company, and, pursuant to a stockholders' agreement, College Parent was permitted to fill three of nine board seats. In addition, College Parent agreed to:

- (1) vote in favor of board recommendations regarding director nominations and against nominees not recommended by the board
- (2) vote in favor of the board's recommendation, or pro rata with all other stockholders, for non-routine matters requiring a stockholder vote
- (3) refrain for two years from transferring its newly acquired shares unless the board approved the transfer or if such transfer was made in connection with a third-party tender offer, business combination, or other similar transaction recommended by the board
- (4) refrain for an additional year from transferring its shares to a competitor or any known activist investor appearing on the "SharkWatch 50" list

Limelight issued a press release and filed a Form 8-K with the SEC, which publicly disclosed to all stockholders the terms of the agreement with College Parent. In a proxy statement seeking approval of the transaction, Limelight again publicly disclosed the terms of the contemplated agreement with College Parent. Thereafter, Limelight's fully informed and disinterested stockholders voted overwhelmingly in favor of the transaction. Following disinterested stockholder approval, the acquisition closed and the stockholders' agreement was executed.

Two plaintiff stockholders brought a consolidated class action against the legacy Limelight directors and Edgio, alleging defendants breached their fiduciary duties by prioritizing their own interests and approving the acquisition and the terms of the stockholders' agreement. While recognizing that the acquisition was a "boon" and highly favorable to the company, plaintiffs nonetheless alleged the terms of the stockholders' agreement established a 35% voting bloc designed both to entrench, and to deter or defeat any activist threats to, the existing board. To that end, plaintiffs sought only to enjoin the enforcement of the stockholders' agreement; they did not seek damages.

Defendants moved to dismiss the complaint, arguing that the deferential "business judgment rule" applies and protects the board's decisions concerning the challenged provisions of the stockholders' agreement, because enhanced scrutiny is not triggered

under *Unocal* in the absence of a threat and defensive action. Defendants further argued that even if the enhanced scrutiny standard applied, the court must dismiss plaintiffs' post-close claims pursuant to the Delaware Supreme Court's holding in *Corwin v. KKR Financial Holdings, LLC*, because a fully informed, uncoerced majority of the company's disinterested stockholders approved the transaction, which cleansed any alleged breaches of fiduciary duty and restored business judgment review.

Vice Chancellor Zurn denied defendants' motion to dismiss, concluding that plaintiffs sufficiently pleaded allegations warranting a conceivable inference that the challenged terms of the stockholders' agreement were adopted as defensive measures against a perceived threat of investor activism and that enhanced scrutiny under *Unocal* applied. Furthermore, the court held that *Corwin* cleansing does not apply to post-close claims seeking injunctive relief.

The court first analyzed the contours of *Corwin* cleansing. The court noted that the express language of *Corwin* suggests its application is limited to post-close *damages* claims only, which, according to the court, furthers *Corwin*'s underlying policy rationale of ensuring that stockholders may make free and informed choices based on the economic merits of a proposed transaction. The court also grappled with the Delaware Supreme Court's 1995 opinion in *In re Santa Fe Pacific Corp. S'holder Litig.*, which the court described as "a case that plausibly supports the proposition that a stockholder vote cannot cleanse a *Unocal* or *Revlon* claim seeking injunctive relief." Although the court acknowledged the dissimilarities between *Santa Fe* and the present action—in *Santa Fe*, the defensive measures at issue served to pressure a stockholder vote and "worked their effect" before the stockholder vote occurred—the court found its guidance more persuasive than two other 1990s-era precedents, *Stroud v. Grace* and *Williams v. Geier*, both of which had held that a fully informed, uncoerced stockholder vote could serve to lower the standard of review for enjoining defensive measures from enhanced scrutiny to the business judgment rule. The court noted *Stroud* and *Williams* were "inconsistent" with the court's own reading of *Corwin* but concluded that neither *Stroud* nor *Williams* would inform the court's decision because neither was discussed or featured in relevant part in the more recent Supreme Court decision in *Corwin*.

Next, the court determined that plaintiffs' claims warranted enhanced scrutiny under *Unocal*. To trigger *Unocal* enhanced scrutiny, a plaintiff must conceivably plead that a company's board acted with a subjective motivation of defending against a perceived threat and took defensive measures in response to such threat. Here, the court conceded that plaintiffs did not "directly plead that the Board perceived a threat and then responded defensively." But the court found that various factors supported an inference of subjective entrenchment motivation, without questioning the validity of stockholders' agreement voting and transfer commitments writ large. Specifically, the court concluded that the following factors gave rise to a plaintiff-friendly inference of subjective entrenchment motivation with respect to the challenged provisions of the stockholders' agreement:

- (1) the company's stock price and performance difficulties
- (2) the timing of the transaction
- (3) market and analyst commentary that the company could be a target for activists

Interestingly, the court pointed out that plaintiffs had foregone the opportunity to obtain board minutes and materials pursuant to a statutory books-and-records demand and noted that, had they done so, "they may have been able to plead additional facts evincing the Director Defendants' motivations for acting"—seemingly drawing yet another plaintiff-friendly inference from the absence of documents, even though they were documents that plaintiffs chose not to obtain. The court further concluded that the challenged provisions of the stockholders' agreement had a "defensive effect." For these reasons, the court

concluded that the complaint contained allegations supporting “the plaintiff-friendly inference that the directors negotiated the [stockholders’ agreement] with the subjective motive of defending against an activist threat.”

Edgio provides important guidance for boards negotiating stockholder transactions, investments, and changes to corporate governance policies. It seems fair to expect, however, that it may not be the last word on the effect of uncoerced, fully informed stockholder ratification on governance measures that may be characterized as “defensive.” Various transactions, and thus the various terms of same, may be ratified by the stockholder franchise, and stockholders routinely vote on and approve components of transactions beyond the proposed transaction price alone.

The decision also calls into question whether the court would have come to the same result had the disinterested stockholders been required to vote affirmatively for each of the challenged provisions of the stockholders’ agreement independently; in *Santa Fe*, a decision upon which the court relied heavily, “the stockholders did not vote in favor of [the] defensive measures, and so the Delaware Supreme Court declined to find ratification.”

Edgio also raises questions regarding what appears to be an expansion of the reach of *Unocal*’s enhanced scrutiny standard, which had evolved principally as a method to police *unilateral board action*, rather than corporate action approved by a majority of fully informed, uncoerced, and disinterested stockholders. Indeed, unlike *Unocal* and its progeny, *Edgio* did not involve any challenged unilateral board action. To that end, *Edgio* raises significant questions regarding the doctrine of stockholder ratification.

In late May 2023, *Edgio* postponed its upcoming annual stockholder meeting and agreed not to enforce the challenged provisions of the stockholders’ agreement pending trial. And although it is too soon to tell whether *Edgio* will have lasting effects on Delaware corporate jurisprudence, the decision serves as yet another reminder to company boards and advisors to memorialize decision-making processes clearly and comprehensively so as to avoid unwarranted, or even untrue, inferences regarding their subjective motivations for their actions.

Potential Control Does Not Equal Actual Control: Business Judgment Rule Protects Oracle-NetSuite Transaction

In a May 12, 2023 [opinion](#) following trial and post-trial argument, the Delaware Chancery Court found for defendants Oracle founder Larry Ellison and CEO Safra Catz in *In re Oracle Derivative Litig.*, 2017-0337-SG, a shareholder derivative litigation case arising out of Oracle’s \$9.3 billion acquisition of NetSuite. The 10-day bench trial took place in July and August 2022 before Vice Chancellor Sam Glasscock and included two days of testimony by Catz and one day of testimony by Ellison, among other witnesses. The court’s decision comes several months after plaintiffs’ voluntary dismissal, following the post-trial argument, of then-defendant Renée James, the chair of a special committee of the Oracle board overseeing the acquisition.⁸

The original complaint in this matter was filed in 2017 against Ellison, Catz, James, and the other 2016 members of Oracle’s board. The court found demand futility adequately pled as to the claims against Ellison and Catz. *In re Oracle Corp. Derivative Litig.* (Del. Ch. Mar. 19, 2018). Plaintiff dismissed James and the other director defendants, and, subsequently, Oracle formed a Special Litigation Committee to investigate the claims against Ellison and Catz. Following an investigation taking over a year, the Special Litigation Committee made

⁸ Sidley represented James and other directors on the Oracle board (other than Ellison and Catz) in this matter. The Sidley litigation team consisted of partners Sara Brody, Jaime Bartlett, and Matthew Dolan and associates Stephen Chang, Jennifer Lee, and Chaddy Georges.

the “surprising” decision, per the court, to return the case to plaintiffs to pursue. Over the course of multiple amended complaints, plaintiffs added back James and the other director defendants and brought claims against certain NetSuite executives. Prior to trial, plaintiffs voluntarily dismissed the other outside directors of the Oracle board (including the other special committee members—former Director of the CIA and Secretary of Defense, Leon Panetta and former CEO of Akamai, George Conrades). The court also granted motions to dismiss Vice Chairman Jeff Henley and the estate of CEO Mark Hurd and the NetSuite executives. See *In re Oracle Corp. Derivative Litig.* (Del. Ch. June 21, 2021); *In re Oracle Corp. Derivative Litig.* (Del. Ch. June 22, 2020).

Central to plaintiffs’ claims were allegations of Ellison’s influence over Oracle’s board and management, including then-co-CEOs Catz and Hurd, and his substantial financial ownership in Oracle and NetSuite stock at the time of the transaction. Plaintiffs asserted that Ellison had used this sway to cause Oracle to overpay for NetSuite to advance his financial interests at a time when NetSuite was purportedly on the cusp of being surpassed in the market by Oracle’s own cloud ERP product. Catz, plaintiffs alleged, had manipulated the special committee to that same end.

Critically, plaintiffs contended that the more exacting entire fairness standard of review, rather than Delaware’s default, and more lenient, business judgment rule, applied to the transaction under two theories: first, because Ellison was purportedly a controller who sat on both sides of the transaction; and second, because Ellison and Catz allegedly had fraudulently misled the special committee, thus disabling its ability to negotiate. The court disagreed on both counts.

As a threshold matter, the court dispensed with plaintiffs’ contention that the business judgment rule was inapplicable because James, as chair of the special committee, had allegedly breached her own duty of loyalty to Oracle in an attempt to curry professional favor with Ellison, tainting the committee’s independence. Plaintiffs made no argument at trial as to the dependence of the remaining committee members, Conrades and Panetta. The court soundly rejected plaintiffs’ arguments on this point, remarking that “[t]his theory, strongly disproved, in [the Court’s] view, by the trial evidence, had some odor of denigrating the abilities of women executives to succeed based on their merits.”

Turning to plaintiffs’ two core theories, the court found Ellison was not a controller such that he caused Oracle to engage in an acquisition in which he was conflicted. A full trial record established only that Ellison was “a holder of potential control over a transaction in which he was interested,” which alone did not mandate entire fairness review. In particular, the court noted that Ellison, who held less than 30% stock in Oracle, did not possess voting control and, more qualitatively, found ample evidence demonstrating that Oracle directors and Catz were not afraid to oppose Ellison—nor did Ellison proffering his ideas “numb [their] minds or overcome [their] business judgment.” The court also highlighted Ellison’s recusal from, and “scrupulous” avoidance of, discussions of the potential transaction with the Oracle board and special committee, as well as the special committee’s “hard-nosed” negotiations with NetSuite, which were antithetical to Ellison’s financial interest.

As to plaintiffs’ second theory, the court found insufficient evidence to support the alleged omissions and misrepresentations to the board and special committee that plaintiffs contended amounted to fraud on the board—including that defendants had purportedly concealed the extent of competition between Oracle and NetSuite in the cloud ERP market and failed to disclose conversations with NetSuite management regarding post-acquisition integration plans. The court likewise found no evidence to demonstrate that Catz had participated in any improper discussion of price with NetSuite management or that she had driven the creation of financial projections that artificially inflated NetSuite’s anticipated performance post-acquisition. Given that plaintiffs failed to adequately rebut the business judgment rule under either theory, the court found in favor of defendants Ellison and Catz.

M&A DEVELOPMENTS

“Springing Rights” Are Not Permissible When a CFIUS Filing is Mandatory

The Committee on Foreign Investment in the United States (CFIUS) recently issued a clarification (through [updated FAQs](#)) that certain “springing rights” arrangements are not permissible when a transaction would require a mandatory filing. CFIUS has jurisdiction to review certain kinds of “covered transactions” involving an investment by a foreign person in a U.S. business. In most cases, filings before CFIUS in connection with covered transactions are voluntary. However, certain transactions that afford a foreign investor certain governance or information rights in “TID U.S. businesses” could trigger a mandatory CFIUS filing. TID U.S. businesses include businesses involved in “critical technology,” “critical infrastructure,” or the collection or maintenance of sensitive personal data. For example, a CFIUS filing would likely be mandatory if a foreign investor acquires the right to appoint a director or observer to the board of a U.S. company that develops, designs, tests, manufactures, produces, or fabricates “critical technology,” for instance, technology subject to certain export control restrictions.

If a CFIUS filing is mandatory, the filing must be made at least 30 days prior to the “completion date,” that is, the “earliest date upon which any ownership interest, including a contingent equity interest, is conveyed, assigned, delivered, or otherwise transferred to a person, or a change in rights that could result in a covered control transaction or covered investment occurs.” Failure to submit a CFIUS filing by the deadline could result in monetary penalties up to the value of the transaction, and other potential consequences.

In many cases, parties have a commercial need to close a transaction as soon as possible. This situation might arise, for example, if the U.S. business is in urgent need of funding, such that waiting 30 days may place the U.S. business in difficult financial circumstances. In such situations, parties have sought ways to expedite financing without triggering an immediate mandatory filing while still giving CFIUS the opportunity to review the transaction before the foreign investor acquired the governance and information rights that would result in a covered transaction. One solution often used in these circumstances was a “springing rights” arrangement.

In a typical springing rights arrangement, the investor would immediately acquire equity interests that would not in themselves result in a covered transaction (e.g., nonvoting equity or a small, noncontrolling equity interest) but would hold its governance/information rights in abeyance until CFIUS approval, at which time the investor’s governance or information rights would “spring.”

Through a recent FAQ, CFIUS clarified that springing rights arrangements are not permissible in a mandatory filing context. The CFIUS clarification and CFIUS regulations do not require that parties wait until CFIUS clearance before closing a transaction. As the CFIUS clarification states, in a mandatory filing situation, the parties must file with CFIUS at least 30 days before closing on any equity interest. However, they may close on the equity interest 31 days after filing with CFIUS, even if CFIUS has not yet approved the transaction. They could also choose to close on the investor’s information and governance rights at that same time or continue to hold those rights in abeyance until CFIUS clearance.

The CFIUS clarification applies to transactions that have already closed or are pending as well as to future transactions. It does not, however, implicate transactions where CFIUS filings are only voluntary. Therefore, if the rights that the foreign investor would acquire would result in a “covered transaction” but would not trigger a mandatory filing, then springing rights are permissible. The parties may still choose to close on the initial equity interests immediately but hold the relevant governance and information rights in abeyance until CFIUS approval. In some cases, parties may choose this arrangement so as not to appear to “prejudge” the result of any CFIUS process.

For more information on the CFIUS clarification and its impact on certain “springing rights” investment arrangements, see the Sidley Update available [here](#).

CORPORATE GOVERNANCE DEVELOPMENTS

A Word of Caution for Boards Navigating Potential Disputes Among Directors or With Funds They Manage

The boardroom frequently presents attorney-client privilege and work product protection issues. The Delaware Chancery Court's recent [decision](#) in *Hyde Park Venture Partners Fund III, LP v. FairXchange, LLC*, C.A. No. 2022-0344-JTL (Del. Ch. Mar. 9, 2023), provides a reminder of the importance of vigilance in considering when and how to limit a director's access to privileged materials in circumstances where directors' interests may diverge—particularly where directors manage, or are affiliated with, investment funds owning stock of the company.

As *Hyde Park* makes clear, under the “joint client rule” in Delaware, “[a] director’s ability to access corporate information affects whether a corporation can claim that a communication was confidential as to the director and thereby invoke the attorney-client privilege.” Under Delaware law, a “director’s right to information is ‘essentially unfettered in nature,’ and that right includes access to privileged material” because “ ‘[d]irectors of Delaware corporations are generally entitled to share in legal advice the corporation receives.’ ” In short, in the normal course, “the corporation has no expectation of confidentiality as to a director,” and “the general rule is that ‘a corporation cannot assert the privilege to deny a director access to legal advice furnished to the board during the director’s tenure.’ ” Of course, “[w]hen a director’s tenure ends, the director leaves the circle of confidentiality for purposes of any subsequent communications, but that does not retroactively alter the fact that the director was within the circle of confidentiality for purposes of communications during his tenure.”

Significantly, because “human beings [cannot] partition their brains,” Delaware courts also hold that where a director is a representative of an investment fund invested in the corporation’s stock, such investment fund “in effect[] is a member of [the company’s] board” and the investment fund is “as much the ‘client’ of [the board’s outside counsel] as [the other directors] are.” What’s more, because the rationale for the rule depends only on the director’s ability to access the privileged information, it does not matter whether the director ever in fact received the information.

In *Hyde Park*, Ira Weiss was a director of FairXchange, Inc. (FairX or the company) as well as a partner and manager of two venture capital investment funds. In connection with the funds’ investment, FairX issued preferred stock to the funds, granting them a 15% equity stake as well as the right to designate a representative director—Weiss. As a director of FairX, Weiss routinely received and had access to privileged communications from the company’s outside counsel.

FairX sought an investment from a third party in the summer of 2021, but after due diligence, the third party instead sought to acquire the entire company. Shortly after receiving the preliminary offer, Weiss wrote to the other directors: “While we should be flattered by this surprise offer, I believe we have to take a step back and make sure that (1) selling now would maximize shareholder value, and (2) if we do sell now, that we are getting a market price for the company.” Weiss wanted the company to retain an investment bank for purposes of undertaking a sale process to solicit bids from other potential buyers and said that he would not vote to approve the transaction without such a market check. Four days later, the other directors rejected Weiss’s proposal and decided to move forward with the third party’s offer to buy the company. Weiss thereafter was informally frozen out by the other directors as the company and the third party worked on the transaction.

A few weeks later, Weiss served a director’s books and records request pursuant to DGCL Section 220(d) on the company, seeking a wide variety of documents and communications related to the transaction. Behind the scenes, FairX’s other directors understood that the third party wanted unanimous director approval of the transaction, and they had been

In Hyde Park, the Delaware Chancery Court highlights the importance of a factual predicate supporting an expectation of confidentiality, finding that an informal freeze-out of a director with potentially conflicting interests by the company's other directors was insufficient to support an assertion of privilege as to the conflicted director.

seeking consent from the majority of the company's other preferred stockholders to remove Weiss as a director. The day after Weiss served his books and records request, the other directors secured consent from the majority of the other preferred stockholders to remove Weiss from the board and informed him that they no longer considered the books and records request to be "relevant." The next month, the company's board unanimously approved the transaction, and the transaction closed shortly thereafter.

The funds commenced an appraisal proceeding, and during discovery, FairX and its outside counsel asserted attorney-client privilege over materials prepared during Weiss's tenure as a director. The company further believed that the funds had received privileged information from Weiss and demanded that the funds destroy that information. The funds moved to compel production of the privileged material, and the company cross-moved for a protective order seeking destruction of the privileged information in the funds' possession.

Applying the general rule that a director is within the company's privilege, the court held that "the Company cannot assert the attorney-client privilege to withhold information generated while Weiss was a director." He explained that "Weiss was...within the circle of confidentiality for purposes of privilege," and "[t]he Company had no expectation of confidentiality as to Weiss."

In reaching this conclusion, the court emphasized that the company and the other directors never took the necessary steps to establish a factual predicate supporting an expectation of confidentiality as to Weiss or the funds. Informally freezing him out of discussions after Weiss expressed his wish to undertake a sale process instead of accepting the existing offer from the third party was not enough. The court explained that the "Company did not take any of the recognized steps that would have created an expectation of confidentiality as to Weiss and provided the factual predicate for asserting privilege." For example, before ultimately removing Weiss from the board, the company did not (1) enter into an ex ante confidentiality agreement with Weiss, (2) form a special committee for purposes of considering the transaction, or (3) otherwise put Weiss on notice that the other directors considered him adverse to the company's interests with respect to the third-party transaction. In addition to rejecting the argument that the informal freeze-out by the company's other directors was sufficient to support the assertion of privilege as to Weiss, the court rejected arguments that the merger extinguished Weiss's rights to the privileged material and that Weiss's removal from the board applied retroactively to extinguish his rights to the privileged materials created prior to his removal.

Ultimately, the court found that the funds, by virtue of Weiss's role as a director of the company, were entitled to discovery of all of the privileged materials related to the third-party transaction that were created up until Weiss was removed from the board. However, the court did allow the company to assert privilege over documents related specifically to Weiss's inspection request.

With the variety of hats that directors may wear, the Delaware Chancery Court's decision in *Hyde Park* serves as an important reminder. Companies and their boards must be attentive to directors' access to privileged materials when the potential for disputes among directors or the funds they represent arises. They should make sure to take the steps set out by the court in *Hyde Park* to preserve the company's opportunity to assert privilege against a director and/or the funds they represent in the event of resulting books and records demand or litigation.

Expect More Delaware Corporations to Propose Officer Exculpation Charter Amendments Next Proxy Season

Given the success of management proposals to amend charters to provide for officer exculpation during the 2023 proxy season, we expect many more Delaware corporations to include such proposals in their 2024 proxy statements.

Effective August 1, 2022, an amendment to Section 102(b)(7) of the DGCL allows any 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 breach of the duty of care. Previously DGCL Section 102(b)(7) afforded this protection only to directors, and it has become standard practice for public companies to provide for director exculpation in their charters. Similar to directors, officers cannot be exculpated for (1) breaches of the duty of loyalty, (2) acts or omissions not in good faith or that involve intentional misconduct or a knowing violation of law, or (3) receipt of an improper personal benefit. Unlike directors, officer liability cannot be eliminated or limited for derivative suits or claims brought directly by the corporation.

The corporate officers eligible for exculpation from personal liability are:

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

An amendment to a company's charter to add an exculpatory provision requires board and stockholder approval and the filing of a preliminary proxy statement. If approved by stockholders, the company must file the charter amendment with the Delaware Secretary of State. The exculpatory provision will apply with respect to acts and omissions only while it is in effect.

There are several benefits of limiting the personal liability of officers including attracting and retaining talent (on the theory that officer exculpation will eventually become a standard governance feature) and potentially discouraging frivolous lawsuits. Notwithstanding the advantages, many public companies adopted a wait-and-see approach for 2023, eager to see voting results and proxy advisory firm vote recommendations during the 2023 proxy season before making a decision. Other companies held off this year for practical reasons, such as the infeasibility of a preliminary proxy statement filing or a desire to wait to amend their charter for officer exculpation when making other amendments in the near term.

ISS and Glass Lewis proxy voting policies for the 2023 proxy season indicated that they would evaluate officer exculpation charter amendment proposals on a case-by-case basis, taking into account specified factors. During the 2023 proxy season, ISS has recommended in favor of exculpation proposals except in very limited instances (e.g., where it identified significant governance concerns). On the other hand, Glass Lewis has consistently recommended against officer exculpation proposals for meetings held in 2023.

According to ISS Voting Analytics data, as of June 26, 2023, approximately 200 Delaware corporations in the Russell 3000 have included proposals to amend their charters to provide for officer exculpation since the DGCL amendment took effect last summer. Of the 188 charter amendment proposals that have gone to vote so far at annual stockholder meetings, only 18 proposals have failed—most often due to charters requiring supermajority approval for amendments. Average support for officer exculpation charter amendment proposals has been 72%.

Given the steady support from shareholders and ISS, we expect that many Delaware corporations will include an officer exculpation charter amendment proposal on the ballot for their 2024 annual meetings. Companies that plan to do so should build in time for board and stockholder approval and a preliminary proxy statement filing in their 2024 annual meeting timelines.

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SEC DEVELOPMENTS

Listed Companies Must Adopt Dodd-Frank Compliant Clawback Policies by December 1, 2023

In October 2022, the SEC adopted [final rules](#) relating to the recovery of erroneously awarded incentive-based executive compensation also known as the “clawback” rules. The long-awaited rules implemented Section 954 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 which added Section 10D to the Securities Exchange Act of 1934. The rules directed the national securities exchanges to establish listing standards that require companies to adopt, disclose, and comply with a written compensation clawback policy as a condition to listing securities on a national securities exchange. The policy would apply in the event the company is required to prepare an accounting restatement due to the company’s material noncompliance with any financial reporting requirement under the securities laws. The policy must mandate the recovery of any incentive-based compensation awarded to a current or former executive officer in excess of compensation that would otherwise have been received during the three-year period preceding the date the company is required to prepare an accounting restatement. The rules also require listed companies to file their clawback policies as an exhibit to their Form 10-Ks and to disclose certain information if recovery is triggered under the policy. For a more detailed summary of the SEC’s final clawback rules, see the Sidley Update available [here](#).

Under the final rules, each national securities exchange was required to file its proposed listing standards no later than 90 days following the date of publication of the final rules in the *Federal Register*, which was November 28, 2022. The listing standards must be effective no later than November 28, 2023 (one year following the final rules publication date). Each listed company must adopt a compliant clawback policy no later than 60 days following the date on which the applicable listing standards become effective. The mandated clawback policies must apply to any incentive-based compensation received on or after the effective date of the applicable listing standards.

The NYSE and Nasdaq initially proposed their listing standards on February 22, 2023, which provided that they would take effect immediately upon SEC approval. Based on commentary by the SEC in April about its expected timing for approving the proposed listing standards, listed companies were anticipating an effective date in early June 2023, which would have required them to adopt Dodd-Frank compliant clawback policies by early August 2023.

In a welcome development, on June 5 and 6, 2023, respectively, the NYSE and Nasdaq filed amended versions of their proposed listing standards extending the effective date to October 2, 2023. On June 9, 2023, the SEC approved the amended listing standards proposed by the [NYSE](#) and [Nasdaq](#). Accordingly, each listed company is required to (1) adopt a Dodd-Frank compliant clawback policy by December 1, 2023 (i.e., no later than 60 days following the October 2, 2023 effective date), (2) comply with its clawback policy for all incentive-based compensation received by executive officers on or after October 2, 2023, and (3) provide the disclosures required by the final rules in applicable SEC filings on or after October 2, 2023. This means that for calendar-year companies, the disclosures will first be required in the 2023 Form 10-K, including the requirement to file the clawback policy as an exhibit.

Listed companies that fail to adopt and comply with the new rules, when implemented, will be subject to potential delisting, although the amended NYSE listing standards now align with the Nasdaq listing standards and provide for cure periods before the commencement of suspension and delisting procedures.

Though not required by the NYSE or Nasdaq listing standards, some companies that are amending their clawback policies may take this opportunity to add a provision permitting the company to claw back compensation if an executive officer engages in misconduct.

Even though listed companies have more time than originally thought to adopt Dodd-Frank compliant clawback policies, they should evaluate their existing policies and socialize any expected changes with their boards in the near term. They should also schedule adequate time for board and compensation committee review and approval of a new or amended clawback policy in the back half of 2023. In light of the potential for recovery and the inability to waive recovery, listed companies should consider whether they may need to develop processes for recovery of compensation in the event of a restatement. As always, establishment of solid internal controls related to financial reporting is imperative to reduce the likelihood of any restatement.

New SEC Rules Will Require More Detailed, Quarterly Disclosure of Buybacks and Rule 10b5-1 Plans Starting With the 2023 Form 10-K

In May 2023, the SEC adopted [rule amendments](#) to require more detailed disclosure surrounding repurchases of an issuer's registered equity securities, often called buybacks. The final rules require issuers to disclose a table of daily quantitative share repurchase information in quarterly or semi-annual reports. This periodic reporting of repurchase activity is a welcome change from the [rule proposal](#), which contemplated next-day reporting of buybacks. The final rules also require narrative disclosure in periodic reports about an issuer's repurchase programs and practices and details about an issuer's adoption and termination of Exchange Act Rule 10b5-1 trading arrangements.

Quarterly Tabular Disclosure. Corporate issuers that report on domestic forms must disclose in a new Exhibit 26 to Forms 10-K and 10-Q historical daily share repurchase activity for each day on which a repurchase occurred. Tabular disclosure in a specified format must include, among other items:

- the class and total number of shares repurchased and average price per share paid and whether shares were purchased as part of a publicly announced plan or on the open market
- aggregate maximum number of shares that may yet be repurchased under a publicly announced plan

Issuers must also include a new checkbox above the table indicating whether specified officers and directors purchased or sold equity securities subject to the share repurchase plan in the four business days before or after the plan's announcement (including an increase of an existing plan). In a change from the proposal, the final rules also require issuers to disclose in a footnote to the table the date of adoption or termination for any plan intended to satisfy the Rule 10b5-1(c) affirmative defense. The final rules eliminate the existing Regulation S-K Item 703 requirement to disclose monthly repurchase data in periodic reports.

Quarterly Narrative Disclosure. Expanding on the required narrative disclosure in periodic reports about executed repurchases, issuers must now disclose in Forms 10-K and 10-Q:

- the objectives or rationales for each repurchase plan and the process or criteria used to determine repurchase amounts
- any policies and procedures relating to purchases and sales of the issuer's securities by its officers and directors during a repurchase program, including any restrictions on such transactions
- any Rule 10b5-1 trading plans adopted or terminated by the issuer

For domestic corporate issuers with a calendar year-end, the new disclosures will first be required in the 2023 Form 10-K, covering repurchase activity and trading plan adoptions and terminations during the fourth quarter of 2023.

The SEC has been keenly focused on climate change disclosures recently even before finalizing its rules later this year. In September 2021, the SEC Staff released a [sample letter](#) to companies reminding them of their disclosure obligations regarding climate change, including compliance with the SEC's 2010 interpretive guidance on climate change disclosures. Since publishing the sample letter, the SEC Staff has issued comment letters to more than 100 public companies flagging deficiencies with their climate-related disclosures.

The final rules impose aggressive compliance deadlines. Domestic corporate issuers must include the quantitative data as an exhibit and provide the narrative disclosure beginning with their Forms 10-K and 10-Q filed for the first full fiscal quarter that begins on or after October 1, 2023. This means that for calendar-year companies, the disclosures will first be required in the 2023 Form 10-K, covering repurchase activity and trading plan adoptions and terminations during the fourth quarter of 2023. For more information, see the Sidley Update available [here](#).

SEC Targets October 2023 to Finalize Key Rulemakings, Including on Climate Change and Cybersecurity Disclosures

The SEC recently released an ambitious spring 2023 rulemaking [agenda](#) revealing that it intends to take action on several key rulemakings in the next few months. Specifically, the SEC plans to adopt final rules on [climate change disclosure](#), [cybersecurity risk governance](#), [SPACs](#), and [modernization of beneficial ownership reporting](#) by October 2023; each was originally slated to be finalized by April 2023. Consistent with the previous version of the agenda, the SEC still plans to issue final amendments on [shareholder proposals under Rule 14a-8](#) by October 2023 as well.

The SEC has delayed its timing for proposing certain ESG-related rules. The SEC expects to propose rules on [human capital management disclosure](#) by October 2023 (deferred from April 2023). Finally, plans to propose a rule enhancing corporate board diversity disclosures were extended from October 2023 to April 2024. Note that the projected dates for finalizing or proposing rules in the agenda are merely approximations and remain subject to change. Nevertheless, reporting companies should assume the SEC will hit its new targets and plan accordingly.

The following summarizes the key rule proposals expected to be finalized in the coming months and recommends action items companies may consider taking in anticipation of the final rules.

In March 2022, the SEC issued [proposed rules](#) that would require public companies to include extensive climate-related information in their registration statements and periodic reports. The proposed rules would require disclosure concerning climate-related risks and impacts, oversight and governance of climate-related risks, climate-related financial statement metrics, climate-related goals, and greenhouse gas emissions. The Sidley Update summarizing the rule proposal is available [here](#). Companies may consider conducting a gap analysis to prepare for the new disclosures and evaluating existing climate-related risks, targets, and goals in light of the potential new disclosure requirements.

In March 2022, the SEC proposed [new cybersecurity rules](#) to enhance and standardize disclosures regarding cybersecurity risk management, strategy, governance, and incident reporting by public companies. The Sidley Update summarizing the rule proposal is available [here](#). Companies would be well advised to evaluate their cybersecurity risk management, strategy, and governance (including board and management expertise) in light of the potential new disclosures. Depending on the final rules, companies may consider updating their committee charters and/or corporate governance guidelines as well as their disclosure controls regarding potential reporting of material cyber-incidents.

In July 2022, the SEC [proposed rule amendments](#) that would narrow the circumstances under which a company may exclude a proposal by revising three substantive bases for exclusion: substantial implementation, substantial duplication, and resubmission of a substantially duplicative prior proposal. The Sidley Update summarizing the rule proposal in more detail is available [here](#). Companies should assess their stockholder engagement strategies on an ongoing basis depending on any concerns voiced by their stockholder base or whether there is activism in the company's stock.

SIDLEY RESOURCES

Antitrust/Competition

Sidley Antitrust Bulletins: Top-of-Mind Global Antitrust Issues. These monthly bulletins provide thoughts on topics that are top-of-mind for Sidley's Antitrust team and why they matter to our clients.

[May Antitrust Bulletin](#) (May 30, 2023). In May 2023, a federal judge in Massachusetts blocked an airline alliance that had been set up in the early months of Covid-19, finding that it caused the two competing airlines to function as a single airline. The state of Louisiana filed a motion to intervene in federal litigation relating to a gun-jumping challenge of a hospital merger. The European Commission published a package of measures to simplify its merger procedures, and in the United Kingdom, the much-anticipated Digital Markets, Competition, and Consumers Bill was published in late April. Once enacted, this will lead to significant changes to the UK's competition regime.

[April Antitrust Bulletin](#) (Apr. 20, 2023). A ruling from the U.S. Supreme Court clarified that challenges related to the constitutionality of the Federal Trade Commission can be brought before federal courts even before administrative processes deciding the merits of the case have been completed. Recent comments by Assistant Attorney General Jonathan Kanter highlighted the renewed determination by the U.S. Department of Justice to enforce Clayton Act prohibitions on interlocking directorates. Across the Atlantic, a significant ruling by the Court of Justice of the European Union (EU) confirmed that competition authorities are able to assess below-threshold concentrations under general rules regarding abuses of dominant positions. The European Commission also announced a policy initiative related to its abuse of dominance rules. In litigation related to alleged exclusionary conduct, the U.S. District Court for the Northern District of California sanctioned Google for not taking reasonable steps to preserve its internal communications related to ongoing litigation.

[European Commission Simplifies and Streamlines Merger Control Review Processes](#) (Apr. 25, 2023). On April 20, 2023, the European Commission adopted a merger control package to further simplify and streamline its procedures for reviewing concentrations under the EU Merger Regulation. The updated rules are expected to benefit businesses engaging in unproblematic transactions, as some of the unnecessary burdens of notification are alleviated. The changes will apply from September 1, 2023.

Corporate Governance and SEC Disclosure

[Future-Proofing the Board of Directors](#). To help navigate increasingly complex corporate governance challenges, a recent report titled *A Framework for Governing Into the Future* by the National Association of Corporate Directors (NACD) Commission on The Future of the American Board highlights areas of focus for boards in 2023 and beyond. Sidley partner Holly Gregory was involved in drafting the report, which she also summarized in the May 2023 edition of Practical Law's *The Governance Counselor*.

[Getting the Deal Through—Corporate Governance 2023](#). Sidley lawyers Holly Gregory and Claire Holland authored the United States chapter of *Getting the Deal Through—Corporate Governance 2023*, an annual summary of key corporate governance practices in 19 jurisdictions worldwide. Topics addressed in the chapter include: sources of governance rules and practice, shareholders' rights, duties and liability, anti-takeover devices, board structures, legal duties of the board, and disclosure and reporting requirements. Holly Gregory has served as a contributing author since 2015. Reproduced with permission from *Law Business Research Ltd.*

[What to Expect in SEC Rulemaking: Takeaways From The SEC's Spring 2023 Regulatory Agenda](#) (June 29, 2023). On June 13, 2023, the U.S. Office of Information and Regulatory Affairs released the SEC's spring 2023 regulatory agenda. With 55 total rules in their final or proposed stages and target dates between October 2023 and April 2024, the agenda suggests that the SEC does not intend to slow down its pace of rapid rulemaking.

Cybersecurity

[U.S. Securities and Exchange Commission Proposes Three Rules Related to Cybersecurity, Reopens Comment for One Rule](#) (April 17, 2023). On March 15, 2023, the SEC proposed three rules related to cybersecurity and the protection of consumer information and reopened the comment period for a proposed cybersecurity rule for investment advisers and funds. This significant action would impose new cybersecurity requirements for several SEC-registered entities, including with respect to these entities' policies, incident response and notification procedures, and cybersecurity risk management. This Sidley commentary and analysis discusses the key features of each proposal, including new requirements and differences among each of the proposals.

ESG

[SEC Announces \\$55.9 Million Settlement in First Action Brought by its Climate and ESG Task Force](#) (Apr. 11, 2023). On March 28, 2023, the SEC announced its settlement of ongoing litigation with Vale S.A., a Brazilian mining company. The case, the first brought by the SEC's Climate and ESG Task Force, highlights the SEC's increasing focus on disclosures related to environmental, social and governance (ESG) matters and demonstrates the SEC's willingness to bring enforcement actions under the existing disclosure framework where it views ESG-related disclosures to be false or misleading.

Labor and Employment

[New York's Imminent Non-Compete Ban](#) (June 28, 2023). New York State is poised to join a growing number of states banning outright nearly all prospective non-competes in the near future. The law would become effective 30 days after it is signed by the Governor.

[U.S. National Labor Relations Board General Counsel Issues Memorandum Invalidating Most Postemployment Noncompete Restrictions](#) (May 31, 2023). The anti-noncompetition camp gained another voice in what appears to be a growing choir. The General Counsel of the National Labor Relations Board has opined that noncompetes may interfere with the rights of employees to engage in protected concerted activity.

M&A

[Anatomy of a CVR: A Primer on the Key Components and Trends of CVRs in Life Sciences Public M&A Deals](#) (May 2023). Contingent value rights (CVRs), the public company M&A equivalent of an earnout, are seeing a resurgence in life sciences deals as a means of bridging valuation gaps between buyers and sellers. In this article, Sidley lawyers Sally Wagner Partin, Sharon Flanagan, and Hannah Brown survey CVRs in announced transactions in the past five years—84% of which were in the life sciences and healthcare industries—and highlight key trends and provisions.

[How to Draft Fee-Shifting Provisions in Indemnification Clauses](#) (Apr. 26, 2023). Sidley lawyers Heather Benzmilller Sultanian and Jarrett H. Gross wrote this article for *Legal Dive* cautioning that Delaware courts have determined that even quite broad language referencing attorneys' fees may not be explicit enough to shift fees in first-party litigation.

Securities Litigation

[Securities Litigation Against Life Sciences Companies: Eleven Takeaways from 2022](#) (May 17, 2023). This article summarizes key takeaways from Sidley's [2022 Annual Survey of Securities Class Actions in the Life Sciences Sector](#).

White Collar: Government Litigation and Investigations; Corporate Compliance

[Anti-Corruption Quarterly Newsletter](#) (May 1, 2023). In this issue, we analyze significant recent policy announcements by the U.S. Department of Justice, including a revised Corporate Enforcement and Voluntary Self-Disclosure Policy and revised Evaluation of Corporate Compliance Programs guidance. We also spotlight the major anti-corruption enforcement actions brought against corporations and individuals in the first quarter of 2023.

SIDLEY EVENTS

Sidley Corporate College

September 13-14 | Chicago, New York City, and Virtual

Sidley will host its annual Corporate College program in Chicago, New York City, and virtually on September 13-14. Sidley's Corporate College is a program intended to expose participants to a broad spectrum of topics likely to be encountered by a transactional lawyer. In-house lawyers of all levels are invited to attend this program. Anyone interested in attending should contact chevents@sidley.com.

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