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SIDLEY

ANALYSIS

ACTION ITEMS FOR U.S. PUBLIC COMPANIES TO CONSIDER FOR 2024

By Beth Berg and Claire Holland¹

Rapid rulemaking and aggressive enforcement by the Securities and Exchange Commission (SEC), combined with legislative, judicial, and regulatory developments, have created new requirements and expectations for U.S. public companies. As we approach year end, such companies might consider taking the following actions in 2024.

1. **For Delaware corporations, consider amending your charter to provide for officer exculpation if you have not already done so.** Since August 2022, it has been permissible for Delaware corporations to extend exculpation protection to specified corporate officers. Given the steady support for officer exculpation charter amendment proposals from shareholders and ISS in 2023, we expect many Delaware corporations to seek shareholder approval of these amendments in 2024. Companies should build in time for board approval as well as a preliminary proxy statement filing. See the Sidley article [here](#).
2. **Implement systems to ensure compliance with the new SEC cybersecurity disclosure requirements.** Beginning on December 18, 2023, companies must disclose a material cybersecurity incident under Item 1.05 of Form 8-K within four business days of determining that the incident is material, with limited exceptions. The materiality determination must be made “without unreasonable delay” after discovery of the incident. If companies have not already done so, they should update their incident response plans and related processes to ensure that a timely determination can be made regarding the materiality of cybersecurity incidents and implement procedures to promptly notify the internal team in charge of SEC reporting of material incidents requiring disclosure. Companies should also review existing cybersecurity risk management, strategy, and governance practices in light of the new cybersecurity disclosure requirements that will first apply to 2023 Form 10-Ks. See the Sidley Update [here](#) and listen to the Sidley Podcast [here](#).
3. **Stay apprised of recently adopted climate-related directives and laws in the European Union (EU) and California as well as the pending SEC climate disclosure rules expected by April 2024.** Non-EU companies with a significant presence in the EU or with securities listed on an EU-regulated market will become subject to broad new EU rules on corporate sustainability due diligence and disclosures (the Corporate Sustainability Reporting Directive) beginning in 2024. Companies with EU operations should assess whether and which entities in their corporate structure are within the scope of the new EU rules and begin determining how and when to adapt their corporate sustainability policies and processes to comply. See the Sidley Updates [here](#) and [here](#).

Whereas many public companies already publish voluntary climate-related disclosures in reports outside of SEC filings, the SEC rules, if adopted, will require public companies to disclose such information in SEC filings according to rigorous methods and standards prescribed by the SEC, and certain of this information would be subject to attestation or independent audit requirements. While the rules pertain only to disclosures, they will impact operations by indirectly requiring companies to take action, to the extent they are not already doing so, to put monitoring, accounting, planning, and governance practices in place to enable them to satisfy the disclosure requirements. See the Sidley Updates [here](#) (California laws) and [here](#) (proposed SEC rules).

We expect many Delaware corporations to seek shareholder approval of officer exculpation charter amendments in 2024.

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Companies should ensure that they have policies and procedures for confirming that trading plans to be used for share repurchases are consistent with the authorizing resolutions and Rule 10b5-1, if applicable.

4. **Consider whether any updates to corporate diversity, equity, and inclusion (DEI) programs, policies, or disclosures are advisable in the wake of the U.S. Supreme Court's June 2023 affirmative action decision.**² Although the Supreme Court's ruling that university admissions policies must be "color blind" under the Equal Protection Clause of the U.S. Constitution is, by its terms, limited to higher education, there have already been high-profile lawsuits and challenges to corporate diversity initiatives, and companies face heightened risk of such challenges to their DEI policies and programs following the ruling. Companies can take steps to continue to advance diversity in the workplace while reducing their legal risk, including by auditing and considering updates to their existing DEI programs, policies, and disclosures. Given the highly dynamic legal landscape around these issues, this is an area to watch closely as case law and trends evolve in 2024. See the Sidley Update [here](#) and listen to the Sidley Podcast [here](#).
5. **Prepare for compliance with the new EU Foreign Subsidies Regulation (FSR), if applicable.** The FSR imposes mandatory filing and approval requirements for M&A deals where (a) the group being acquired, the joint venture being created, or at least one of the merging groups being combined has a business presence in the EU and an aggregate turnover in the EU of at least €500 million in the previous financial year, and (b) the parties to the deal, in the aggregate, received at least €50 million in financial contributions from non-EU countries (foreign financial contributions or FFCs) in the three years prior to executing the transaction agreement. In addition, the European Commission may require below-threshold deals to be notified. To avoid deal delays, parties at risk of meeting notification thresholds should take an inventory of FFCs received from non-EU countries in the past three years and implement systems to ensure that those contributions are tracked on an ongoing basis. Preparing this inventory may be complicated, given that "foreign financial contributions" is broadly defined and includes Covid-19 support, support for renewable energy, tax exemptions, and any transactions with public bodies (e.g., public utilities, state hospitals). See the Sidley Updates [here](#) and [here](#).
6. **Ensure that share repurchases comply with board authorizations.** In November 2023, the SEC announced that it settled charges against a company for insufficient internal accounting controls relating to its share repurchases, which did not conform to SEC Rule 10b5-1 as required by the authorizing resolutions adopted by the company's board. The company agreed to pay a civil penalty of \$25 million. This enforcement action serves as a reminder that companies should ensure that they have policies and procedures for confirming that trading plans to be used for share repurchases are consistent with the authorizing resolutions and Rule 10b5-1, if applicable.
7. **Update insider trading policies and procedures in light of the new SEC rules.** Companies should ensure that their Rule 10b5-1 plans and insider trading policies comply with the December 2022 amendments to Rule 10b5-1 (e.g., new cooling-off periods). A calendar-year company will first be required to file its insider trading policy as an exhibit to its 2024 Form 10-K. Prior to that time, companies should revise their insider trading policies to (a) explicitly add gifts to the types of transactions covered by the policy and (b) permit insiders to use written trading arrangements other than Rule 10b5-1 plans. Finally, companies should review their policies and remove any content that may be extraneous or better suited for an internal memorandum. See the Sidley Update [here](#).
8. **Proactively prepare for shareholder activism; confirm there are no illegal director interlocks.** Particularly given the current universal proxy rules, companies are well advised to review director biographies in proxy statements and on corporate websites to ensure they reflect the strengths, qualifications, and relevant experience of individual directors. Before any activist situation arises, companies should also assess their

² *Students for Fair Admissions, Inc. (SFFA) v. President & Fellows of Harvard College*, No. 20-1199, and *SFFA v. University of North Carolina, et al.*, No. 21-707 (June 29, 2023).

A corporate interlock violates Section 8 of the Clayton Act when a “person” serves as an officer or a director of two competing companies that exceed certain jurisdictional thresholds.

vulnerabilities and ask experienced proxy contest counsel to review their corporate bylaws to ensure that they reflect current best practices. See the Sidley article [here](#). Companies should also confirm that they have no interlocking directorates in violation of the Clayton Act. Enforcement by the Federal Trade Commission (FTC) and the Department of Justice (DOJ) resulted in more than a dozen director resignations in 2023, as discussed in the Sidley article [here](#).

9. **Ensure that the board understands the impact of artificial intelligence (AI) on corporate strategy and risk.** Corporate boards need to understand and stay apprised of AI-related legislative and regulatory initiatives in the U.S. and abroad and oversee the company’s compliance, as well as the development of relevant policies, information systems, and internal controls, to ensure that AI use is consistent with legal, regulatory, and ethical obligations, with appropriate safeguards to protect against risks. See the Sidley articles [here](#) and [here](#) and watch the Sidley webinar on the EU AI Act [here](#).
10. **Refresh policies on corporate statements about high-profile social and political issues.** Companies may face negative consequences to their business or reputation whether they speak or stay silent. Accordingly, companies may wish to consider adopting policies and processes for determining what issues to speak out on and when, who has authority to speak, and which types of statements (if any) require board notification or prior approval. These decisions should align with a company’s core values and take into account the potential benefits and risks associated with taking a position. See the Sidley article [here](#).
11. **Make sure that non-GAAP disclosures comply with SEC rules and guidance.** SEC staff guidance issued in December 2022 and a March 2023 enforcement action illustrate the SEC’s continued scrutiny of non-GAAP reporting. Companies that use non-GAAP measures in their public filings should ensure that they have adequate disclosure controls and procedures in place to comply with applicable SEC rules and guidance, particularly the requirement to disclose the most directly comparable GAAP measure with equal or greater prominence (as construed by the SEC).
12. **Make sure employee agreements do not impede whistleblowing.** The SEC has recently brought enforcement actions against companies alleging that they entered into agreements with employees that the SEC found impeded potential whistleblowers from reporting complaints to the SEC. Companies should review agreements with current and former employees and delete any language that purports to restrict employees from communicating with government agencies.

HOW M&A LAWYERS CAN HELP CLIENTS BRIDGE THE VALUATION GAP

By Justin Macke³

Over the last decade, M&A transaction values were pushed to all-time highs by the convergence of (1) a considerable migration of capital from public markets to private markets, most notably to private equity funds, (2) historically low interest rates and inflation rates, (3) a ubiquitous adoption of representation and warranty insurance (RWI) by M&A participants, and (4) historically low costs of capital in the debt markets.

To compete in this environment, buyers were forced to move expeditiously through due diligence and accept transaction terms that became more seller-friendly each year. As a result, transaction terms, especially in private equity transactions, moved toward a new set of “market deal terms”—a leveraged buyout with “no recourse” to seller (i.e., seller provided

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To find ways to transact in this challenging M&A environment, buyers and sellers are increasingly looking to investment bankers and legal counsel to offer creative ways to bridge the gap on value.

expanded representations because buyer's only recourse for a representation breach was under its RWI policy).

Macroeconomic headwinds, including widespread fear of an upcoming recession, and increases to interest rates have slowed M&A markets during the past year. Deal uncertainty has led to a dramatic decrease in transaction value and total number of deals announced. "Busted deals" have been on the rise in 2023 as a result of financing failures and impasses on value. With real interest rates expected to stay at levels that have not been seen since the Great Recession, we can expect to see continued disconnects on price.

To find ways to transact in this environment, buyers and sellers are increasingly looking to investment bankers and legal counsel to offer creative ways to bridge the gap on value. Deal lawyers wanting to best-position their clients, especially sponsors, to transact may consider dusting off their old M&A playbooks to revisit once-common transaction devices to help bridge the valuation gap, including the following.

Minority Sales; Preferred Equity

A minority sale involves the purchase by buyer of less than 50% of the equity of the target business. A minority transaction allows seller to monetize a portion of its equity without handing over full control of the business to buyer at a discount value. Seller retains the ability to get a second bite at the apple in selling control of its company at a later date. The transaction permits buyer to acquire a stake in an interesting target at a discounted price to what it would pay in a control transaction.

Additionally, a minority transaction may be a more passive investment for buyer, who usually receives certain minority protections and veto rights over significant decisions at the company but is otherwise not responsible for the day-to-day cost and expense of managing the company. The minority transaction also provides the parties with the opportunity to further explore a future sale transaction once buyer has been "under the hood" of the company as an owner.

Preferred equity is security that generally provides for a priority claim over common stock on dividends, liquidation distributions, and sale proceeds. Preferred equity is most commonly issued in connection with minority sales. A preferred equity instrument often has debt-like terms where the holder's priority right is for a return of capital plus a preferred return percentage.

Preferred equity is, however, junior to all debt and trade creditors. Preferred equity deals provide a buyer with downside protection through the preference right, and in the context of convertible preferred equity, the ability to share in the potential upside of the business by converting the preferred equity into common equity in connection with a sale transaction. For a seller, preferred equity is typically "more expensive" than common equity, resulting in seller receiving greater closing date proceeds. Also, preferred equity holders usually receive fewer minority protections than common holders, with protections focused on the company's ability to make the preferred payments versus operational limitations on the company.

Earnouts

An earnout is a contractual arrangement by which a seller may be entitled to receive additional consideration if certain specified events happen following the closing. An earnout allows parties to bridge the valuation gap if/when certain milestones are hit while providing buyer with downside protection if such milestones are not hit.

Earnouts are often tied to the financial performance of the target business (e.g., target's post-closing revenue or EBITDA) during specified periods after the closing. However, they can also be tied to non-financial milestones (e.g., target receives FDA approval on a particular drug or upon a product launch). For private equity buyers, the earnout may be

tied to the sponsor's return on investment for the target (e.g., if sponsor reaches a 20% internal rate of return upon the eventual sale of the target business).

For earnouts tied to financial milestones, the parties must consider whether the buyer must hold separate the target business from any other assets that buyer holds during the earnout period. Holding separate the target business makes it easier to account for target's revenue, EBITDA, or other financial measurement, but maintaining two sets of accounting books can increase costs and prevent the full integration of the target to buyer's larger enterprise.

Counsel for sellers should seek to include covenants in respect of how buyer must operate the business post-closing (e.g., buyer must operate the business in a manner intended to achieve the highest possible earnout payment). Counsel for buyers should ensure that such covenants are narrowly tailored so that buyer has the flexibility to operate the business as needed.

Seller Rollovers

Private equity buyers often use seller rollovers to bridge valuation gaps (and serve as a form of seller financing). In an equity rollover, a seller will "roll over" a specified percentage of its equity so that seller retains a minority position in the post-closing business. A rollover decreases the proceeds that buyer is required to deliver at the closing and allows seller the opportunity to share in upward value creation under buyer's control. Depending on the relevant facts and structure of the transaction, the "rollover" portion of the purchase price may be tax deferred for seller until the rollover equity is subsequently sold.

Seller rollovers usually represent a small percentage of the consideration (i.e., less than 20% of the post-closing equity); however, parties should consider larger rollover amounts in situations where a seller is looking to monetize a meaningful portion of the value of the target asset but does not want to fully cash out at the offered price.

The interests of seller and buyer are more aligned in a rollover transaction than in an earnout construct because seller and buyer both own the same equity instrument in the company—thus sharing on a *pro rata* basis in the upside and the downside.

Seller Notes

In lieu of receiving cash for 100% of the equity in target, a seller may issue an interest-bearing note to buyer for a portion of the purchase price. The terms of seller notes are often bespoke and highly negotiated but typically incur interest at market rates. These instruments are customarily unsecured and sit subordinate to any senior or mezzanine debt.

Seller notes provide seller with a way to fully monetize its position and receive a specified return on a portion of the proceeds and provide buyer with an alternative financing source to traditional debt in a transaction where buyer receives full control of the company as of the closing date.

Post-Closing Indemnities

If a buyer and seller want to bridge a valuation gap in the context of a traditional leverage buyout transaction, they may consider a post-closing indemnity structure instead of a "no recourse" deal. Prior to the advent of RWI, sellers customarily stood behind the representations that they gave to buyers via post-closing indemnities. Such indemnities were usually subject to certain negotiated procedures and limitations (e.g., caps, baskets, materiality scrapes, sandbagging provisions). Sellers also regularly provided line-item indemnities for material contingent liabilities that were identified during due diligence.

There are a number of ripple effects caused by moving from a "no recourse" to a true indemnity deal that deal teams should consider. It is typical for seller to give a narrower and more negotiated set of representations than they would in an RWI transaction because seller is standing behind its representations. The representations provided to buyers in recent years have been more standard and robust than those provided a decade ago.

If a buyer and seller want to bridge a valuation gap in the context of a traditional leverage buyout transaction, they may consider a post-closing indemnity structure instead of a "no recourse" deal.

The diligence process has similarly been affected by RWI—many buyers began performing due diligence at only the minimum level needed to underwrite a robust RWI policy. A buyer's due diligence is more important when it has to rely on a thinner set of representations and may be rewarded for identifying risks by receiving indemnity coverage (an exceedingly rare result in the "no recourse" environment).

A generation of deal lawyers and private equity investors has done deals only under the "no recourse" model. Thus, it is important that lawyers reeducate themselves on market deal terms of yesteryear. Lawyers who are willing to dust off the M&A playbook from years past and roll up their sleeves may be the difference for a client seeking ways to deploy capital in this new "real interest, real inflation" environment.

THREE KEY ROLES OF THE BOARD OF DIRECTORS

By Holly J. Gregory⁴

Understanding the three key roles of the board of directors can help shape the board's agenda, establish information priorities, and support trust and transparency in the board-management relationship.

In reaction to ever-increasing business complexity and governance expectations, directors may be tempted to weigh in at a deeper level of detail on a broader range of issues affecting a company. Maintaining clarity about the board's role can help the board set priorities and determine whether and when to dive deeper.

As the highest authority in the company, the board plays three key roles. The board acts as:

- a decision-maker, responsible for making certain decisions including, but not limited to, how much authority to delegate to management, board committees, and others
- an overseer of the authority it has delegated
- a "sounding board" for management, when management would like input on matters within management's delegated authority

Understanding these three distinct roles can help set the board's agenda and information priorities. It can also help support an appropriate relationship of respect and trust among directors and between the board and management.

This article discusses board authority and delegation generally, expands on the three key board roles, and highlights best practices for an effective board-management relationship.

Board Authority and Delegation

State corporation law typically provides that the board is responsible for the management and direction of the corporation. For example, Section 141(a) of the Delaware General Corporation Law (DGCL) provides that "[t]he business and affairs of every corporation...shall be managed by or under the direction of a board of directors." This gives the board broad discretion to delegate management activities to others, subject to certain limitations where the statute requires a final decision to be made by the board.

While the board has clear authority under state law to manage the business, in a company of significant size and complexity, and certainly for publicly traded companies, the company's day-to-day affairs are typically delegated to a professional team of managers led by the CEO. In addition to putting management into the hands of professionals who are employed on a full-time basis to run the company, this also positions the board to serve as an accountability mechanism distinct from the senior management team. In publicly traded

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companies, this separation, combined with a board composition dominated by independent directors, allows the board to provide objective monitoring of management's performance.

While boards have wide discretion (within certain limits) to determine how much authority to delegate to management, determining what to delegate and what to reserve for the board requires careful consideration. Full-time senior management will always have more information about and insight into the business and operations of the company than outside and independent board members. For this reason, in addition to authority for day-to-day operations, management is typically delegated authority to execute and implement strategic and business plans and to make certain non-strategic decisions. Additionally, while the board to varying degrees based on the materiality of an issue may retain final approval, the CEO and senior management typically propose and drive discussions on:

- strategic planning and creative initiatives
- financial goals
- capital and resource allocation
- risk appetite
- talent development
- corporate policies

This reflects the principle that "[e]ffective directors are diligent monitors, but not managers, of business operations. They exercise vigorous and diligent oversight of a company's affairs, including key areas such as strategy and risk, but they do not manage—or micromanage—the company's business by performing or duplicating the tasks of the CEO and senior management team." (Business Roundtable, [Principles of Corporate Governance](#) (2016).)

When allocating authority between management and the board, the board should consider:

- whether directors have the time, information, expertise, and understanding of the business and the industry such that the board's involvement is likely to improve the quality of management's decisions
- the potential for a negative impact on management accountability

"To provide oversight of management and hold it accountable for performance requires that the board function as a body distinct from management, capable of objective judgment regarding management's performance.... Undue board involvement in matters of management may impair the board's ability to provide objective oversight of management performance." (National Association of Corporate Directors, [The Future of the American Board Report: A Framework for Governing into the Future](#) (2022) (membership required) (NACD Future of the American Board Report).) When the board makes management-level decisions, its ability to hold management accountable for outcomes is lessened. Moreover, micro-managing by the board may condition management to await board guidance, and frequent board intervention and second-guessing may cause managers to become risk averse.

In making decisions and overseeing delegated authority, directors should be aware of available protections to minimize liability. One of the most potent director protections is the exculpatory charter provision authorized by DGCL Section 102(b)(7), which immunizes directors against monetary damages for breach of the duty of care. (Companies should note that in August 2022, the Delaware statute was amended to allow Delaware corporations to expand such protections to certain corporate officers (with the exception that claims against officers will not be barred "in any action by or in the right of the corporation").)

Another protective statutory provision for directors is DGCL Section 141(e), which states that "a member of the board...shall...be fully protected in relying in good faith upon the records of the corporation and upon such...reports...presented...by any of the corporation's officers or employees..." or experts. This should encourage the delegation of fact-finding and

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analytical work from the board to management and outside experts, bearing in mind that “good faith” oversight still requires appropriate probing of that work by the board.

The Board’s Decision-Making Role

A recurring corporate governance issue is where to draw the line between the role of the board and the role of the professional management team (see NACD Future of the American Board Report; Business Roundtable, Principles of Corporate Governance (2016)). The board’s discretion to make this determination is subject to legal requirements and stock exchange listing rules, business judgment, and investor expectations. The company’s bylaws may address specific responsibilities and authority and should be reviewed when considering whether to delegate or reserve authority.

Generally, the following decisions are reserved to the board:

- amending the certificate of incorporation and bylaws
- issuing stock and granting equity (e.g., options and warrants)
- recommending actions to shareholders
- filling vacancies on the board
- approving a merger agreement or other material transactions, including engaging in a sale or distribution of all or substantially all of the company’s assets
- borrowing or lending material amounts of money
- declaring a dividend
- approving the company’s strategic direction
- adopting an annual budget
- appointing or terminating the CEO and other senior officers
- establishing board committees
- delegating authority to officers, board committees, and others
- adopting employee benefit plans (including 401(k), profit-sharing, and health insurance plans)
- adopting significant corporate policies
- retaining and overseeing the independent auditor

Delaware case law relating to change-in-control transactions supports the principle that any concrete step to explore the sale of a company should be authorized by the board. Specifically, on these matters, boards should take “an active and direct role...from beginning to end.” (*Cede & Co. v. Technicolor, Inc.*, 634 A.2d 345 (Del. 1993).) Additionally, stock exchange listing standards require that certain decisions related to the retention of the independent auditor, executive compensation, and director nomination and governance be delegated to independent directors or committees populated solely by such directors.

The Board’s Oversight Role

The board must provide oversight of matters that it delegates to management and others, and therefore a significant focus of board activity involves overseeing management’s performance. Oversight is the continual inquiry by directors into whether the board’s delegation of authority to management is reasonable and whether the information that management provides to the board can be relied on.

Typical areas of oversight include:

- strategic initiatives
- operational and financial performance (and the related integrity of financial accounting and reporting processes)
- risk management
- compliance

Oversight of strategy and risk are key areas for board focus (see NACD Future of the American Board Report). The board generally approves corporate strategy that is proposed and developed by management with input from the board, and the board must understand the risks associated with corporate strategy and business operations. In addition to monitoring management's performance in implementing strategy and operating the business, the board must also ensure that management has appropriate risk management and compliance systems in place along with the information and control systems designed to bring risk and compliance issues—especially with respect to “mission-critical” risks—to management's and the board's attention.

Boards must monitor risk on an ongoing basis, and they must do so rigorously with respect to mission-critical risks. Boards need to be prepared to act on risk and compliance issues as they arise and should attend to the board's own structure and processes for oversight of risk and compliance. The taxonomy of risk will differ for each company, but major risks in the current environment include:

- technological and business model disruption
- natural disasters and pandemics
- geopolitical disruptions
- inflation (and the risk of recession)
- access to capital and liquidity concerns
- supply chain issues
- human capital competition
- product safety
- cybersecurity and data privacy
- ESG exposure and associated reputational harm

A majority of public companies vest oversight responsibility for a wide range of corporate risks in their audit committees, which, as required by listing rules, are populated by individuals with financial literacy but who may or may not have experience with the material non-financial risks facing the company. Freestanding risk and legal/compliance committees remain relatively uncommon, as are committees focused on the environment, health, and safety. According to the [2023 Spencer Stuart Board Index](#) survey of S&P 500 companies, 12% of S&P 500 boards have a risk committee, 6% have a legal/compliance committee, and 13% have an environment, health, and safety committee.

Boards should periodically evaluate whether they are appropriately structured for oversight of the critical risk and compliance issues that are most relevant to the company (including whether the board has appropriate composition relevant to mission-critical risk oversight) and should also periodically review the information and control systems designed to ensure that relevant information is brought to the attention of management and the board in a timely manner.

The Board's Sounding Board Role

An effective board is comprised of members with significant experience, skills, and expertise relevant to the company's business. This collective experience and expertise make the board a valuable resource for management. However, it is management's prerogative whether to seek board perspective on matters within management's authority. When the relationship between the board and management is one of mutual trust, respect, and candor, management is more likely to seek board input on important matters. For management to fully use the board as a forum for testing ideas and seeking guidance, management must have confidence that the board or individual directors will not use the opportunity to overstep and micro-manage by giving direction on matters that are for management to decide.

Boards should periodically evaluate whether they are appropriately structured for oversight of critical risk and compliance issues and periodically review the information and control systems designed to ensure that relevant information is brought to the attention of management and the board in a timely manner.

When management consults with the board, the board in turn benefits from the enhanced transparency into management's decision-making processes and earlier involvement in matters that may ultimately require board oversight or even board decision-making. As a practical matter, this sounding board role is often intertwined with the board's oversight role because exposure to how management is thinking about and approaching an issue provides a basis for the board's judgments about management performance and capability. It is important for boards to avoid viewing a sounding board opportunity as a request to take back delegated authority. To avoid confusion, management should clearly indicate when it is bringing an issue forward to obtain the wise and experienced perspective of directors to assist management in its own consideration of the matter.

Practical Guidance

To create a successful dynamic between the board and management and leverage the strengths of both teams, companies should:

- **Adopt a collaborative mindset.** Highly effective boards and management teams collaborate on important matters. For example, while management proposes and develops strategy, it is common for there to be an iterative process between the board and management when significant strategic change is being contemplated. A collaborative mindset helps support a culture of transparency while ensuring that the board and management remain aligned on the company's vision.
- **Regularly assess the board's approach to delegated authority.** The board should periodically review where board and management authority have been set and, in particular, what matters are to be brought to the board for decision and what information is presented to the board for oversight. These discussions can be held in the context of regular education about fiduciary obligations and effective governance practices. The post-annual shareholder meeting period may be a logical time to have these discussions, which may be particularly helpful in orienting new public company directors and activist directors joining the board on how the board has defined board and management roles. The board's formal delegation of authority (or reservation of authority) should be reviewed every several years to ensure that it is clear and remains appropriate. Periodically, the annual board self-evaluation process should inquire into director (and management) views on whether the line between the board's role and management's role has been clearly and appropriately set and whether directors and management understand and are respecting the agreed delineation.
- **Set expectations, including that the board focus and approach may change with the circumstances.** The board should set clear expectations with management of when the board should be informed of company developments in real time and when the board may want to become more deeply involved. Board activity is context dependent, and increased levels of board involvement in decisions and oversight may be appropriate, for example, if:
 - a crisis arises
 - the business needs to pivot in a new strategic direction
 - there has been a period of unresolved underperformance
 - confidence in the CEO has waned or
 - there are other material unresolved issues affecting the company that call for a higher level of board attention
- **Insist on discipline in setting board meeting agendas and information priorities.** Meeting agendas and related information provided to the board should align with board priorities and roles. While priorities will vary from board to board, it is likely that they will involve issues of strategy, risk, and both corporate and CEO performance. The board should expect, and the corporate secretary should ensure, that matters on the board agenda and items provided to the board include an indication of the purpose for which they are

The annual board self-evaluation process should inquire into director (and management) views on whether the line between the board's role and management's role has been clearly and appropriately set and whether directors and management understand and are respecting the agreed delineation.

included, whether for decision, oversight (and background), or to seek director viewpoints as input for a management decision. Directors should use this same discipline when requesting that an item be added to the agenda or when requesting information.

NEWS⁵

JUDICIAL DEVELOPMENTS

Con Ed Uncertainty: Delaware Chancery Court Questions Enforceability of Merger Agreement Provisions Allowing Target to Seek Lost Merger Premium

The Delaware Chancery Court's October 31, 2023 [decision](#) in *Crispo v. Musk* is sure to spook practitioners, as the Court called into doubt the enforceability of "Con Ed provisions." *Con Ed* provisions, so named for the 2005 Second Circuit decision prohibiting stockholders from pursuing a \$1.2 billion merger premium damages claim, create a path for the target's recovery of lost merger premium if the buyer breaches and a deal fails.

The *Crispo* decision is yet another gift-qua-decision arising from the Twitter-Musk dispute. A stockholder sued Elon Musk and related entities for breaching fiduciary duties allegedly owed as a controller and for breaching the merger agreement (before Musk changed course and agreed to close). After dismissing the fiduciary duty claim, the Court considered whether the stockholder had standing to sue for lost-premium damages and requested supplemental briefing as to whether the stockholder could pursue claims based on the merger agreement's *Con Ed* provision, which provided that in the event of breach, the buyer would be liable for "[t]he benefits of the transactions contemplated by this Agreement lost by the Company's stockholders...taking into consideration all relevant matters, including lost stockholder premium." The agreement also, however, expressly disclaimed third-party beneficiaries (with specific carveouts inapplicable here).

The Second Circuit's 2005 *Con Ed* decision held that a broad prohibition on third-party beneficiary status precluded stockholders from seeking to enforce the merger agreement and pursue a claim for lost-premium damages. As Chancellor Kathaleen McCormick explained, this "came as a surprise" to practitioners and created an imbalance between buyer and the target. As one treatise put it, this would shift "the balance of leverage in any MAC, renegotiation, or settlement into an 'option' deal such that the buyer could walk away with little consequence."

"*Con Ed* provisions" were thus born. The Court identified three forms of such provisions, which seek to make the buyer liable for lost stockholder premium in the event of deal failure emanating from a buy-side breach. The type of *Con Ed* provision at issue in *Crispo* is the "Defined Damages Provision," which defines damages recoverable by the target company to include lost merger premium.

The Court held that the Defined Damages Provision and the provision disclaiming third-party beneficiaries could be harmonized together in two ways. First, the Court reasoned that the Defined Damages Provision could be interpreted to be unenforceable on the theory that, because the stockholders are the ones who suffered the lost merger premium and they lack third-party beneficiary rights, the lost merger premium is not recoverable. But that interpretation would violate a "cardinal rule of contract construction," namely, that "a court should give effect to all contract provisions." The Court thus turned to a second plausible interpretation: that the merger agreement could be read to grant "stockholders third-party beneficiary status that vest[s] in extremely narrow circumstances and for the limited purpose

⁵ The following Sidley lawyers contributed to the research and writing of the pieces in this section: Arthur E. Adler, Thomas H. Collier, Christine Duque, Claire H. Holland, Katie Klaben, Charlotte K. Newell, 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.

Con Ed provisions play a critical role in allocating power between buyer and seller. The market will need to adjust quickly in the wake of Crispo and identify mechanisms to address the enforceability questions that the Delaware Chancery Court identified.

of seeking lost-premium damages.” Because *Con Ed* provisions exist to remedy lost premium after the merger has failed, such provisions could not confer standing “while the remedy of specific performance is still available.” Thus, the Court found that the merger agreement could potentially be interpreted to grant a stockholder a limited right to pursue lost-premium damages, under narrowly defined circumstances, which would run “concurrent to the target’s right to pursue damages under the merger agreement.”

To address the enforceability questions that the Court identified, practitioners may consider explicitly addressing lost-premium damages in merger agreements subject to Delaware law. Until market practice settles on new provisions or mechanisms to protect this important sell-side protection and eliminate the uncertainty this decision creates, dealmakers will be left considering whether to (1) formally seek appointment of the target as its stockholders’ agent to pursue a lost-premium damages claim or (2) potentially allocate to stockholders more explicit rights as third-party beneficiaries, running the risk of disproportionately enriching would-be plaintiffs’ counsel and proliferating litigation. There will be pros and cons to all efforts to address these questions, including that they, too, are untested by the courts.

It is also possible that the Delaware General Assembly takes action in the face of this decision. For now, particularly on the sell side, it will be critical to consider and work through with counsel the risks that *Crispo* presents and potential solutions. For a more in-depth analysis of the decision and key takeaways, please see the Sidley blog post [here](#).

Two Cautionary Tales: Fee Shifting Imposed for Litigating Books-and-Records Inspection Demands

While there are [limits](#) to a [stockholder’s right](#) to [inspect books and records](#) under Section 220 of the DGCL or other sections allowing inspection—and corporations can [negotiate the scope of inspection](#)—there are also limits to how vigorously a corporation can resist a stockholder’s inspection demand, particularly when it does not present novel legal issues. Two recent fee-shifting decisions issued by Vice Chancellor Morgan Zurn provide a cautionary reminder of those limits, which the Delaware Chancery Court previously set out in opinions such as *Pettry v. Gilead Scis. Inc.* (2020), *Marilyn Abrams Living Trust v. Pope Invs. Inc.* (2017), and *McGowan v. Empress Entm’t* (2000). The unmistakable message: If the right to inspection is clear, a defendant should think twice about a blanket opposition unless the defendant does not mind paying the plaintiff’s legal fees in the end.

Key to both of these recent decisions was that they involved defendants who took litigation positions that the Court viewed as unsupportable.

In [Seidman v. Blue Foundry Bancorp. \(Blue Foundry\)](#), the plaintiff stockholder was concerned with the corporation’s intention to pay compensation to non-employee directors and senior management that the stockholder felt was excessive, based on the corporation’s financial performance (valued by the corporation at more than \$500,000 per director). The stockholder also launched a “vote no” campaign, requesting that stockholders oppose the corporation’s compensation proposal, including because it lacked a performance standard. After stockholders approved the compensation proposal, the plaintiff sought to inspect compensation consultant reports and formal board materials, alleging both investigative and communicative purposes (*i.e.*, that he wished to communicate with other stockholders to address the foregoing issues “through litigation, proxy contest or by other corrective measures”). The Court rejected the defendant corporation’s argument that under the stockholder-ratification doctrine, the plaintiff was required to demonstrate an actionable claim, noting that *AmerisourceBergen Corp. v. Lebanon Cnty. Emps. Retirement Fund* (2020) requires only that a stockholder establish a “credible basis” from which the Court can infer wrongdoing or mismanagement and that the stockholder need not demonstrate that the wrongdoing or mismanagement is actionable.

Based on two recent Delaware Chancery Court decisions, if the right to inspection is clear, a defendant should think twice about a blanket opposition unless the defendant does not mind paying the plaintiff's legal fees in the end.

In [*Bruckel v. TAUC Holdings, LLC \(TAUC\)*](#), the plaintiff was a "Founder Member" and manager of the defendant LLC who sought inspection under Section 18-305 of the Delaware Limited Liability Company Act as well as the LLC Operating Agreement. The Court found that he had statutory and contractual rights to any material "reasonably related to his status as a manager" (with the "best proxy" being those materials that other managers were receiving) and that the plaintiff's contractual rights did not even have a "proper purpose restriction."

In both cases, the Court found that plaintiffs' inspection rights had been improperly stymied by the defendants, which necessitated litigation. This might itself have been sufficient to shift fees under McGowan, which is cited in both opinions for the proposition that stonewalling a "clearly established" inspection right can amount to bad faith that warrants fee shifting. In both cases, however, the Court pointed to egregious conduct by the defendants—including misstatements as well as stonewalling the plaintiffs' discovery requests—that further justified shifting fees.

In *Blue Foundry*, the defendant corporation refused until the eve of trial to disclose whether responsive board materials even existed, and then produced only roughly 60 pages worth of material. The defendant also insisted on deposing the plaintiff in person in Delaware, despite knowing that the plaintiff was located in Florida; it also insisted on calling the plaintiff for live testimony at trial, ignoring that books and records matters are most typically summary issues that can be decided on a paper record.

In *TAUC*, the defendant's continued refusal to timely produce material to the manager-plaintiff first drew a contempt order, and then a court-appointed receiver to ensure compliance. After the *TAUC* defendant started producing board materials, it did so only on a delayed basis, often rendering the material useless to the plaintiff. Email production was delayed even further. The defendant LLC also changed how it was advising its managers—always omitting one manager per meeting on a rotating basis—in an attempt to minimize the official management materials it might be required to produce to the plaintiff for inspection. The Court also faulted the defendant LLC's privilege designations, noting that it had improperly redacted entire documents; had withheld image files, attachments, and calendar items for no apparent reason; and had inexplicably withheld documents that had been sent by, or shared with, the plaintiff. The Court also noted that "in what is supposed to be a summary proceeding, the docket is littered with letters, and the Court has had a trial, three subsequent hearings, and issued now five rulings."

Finally, Vice Chancellor Zurn expressed concern that the defendants in both cases misrepresented the record in opposing fee shifting. In *Blue Foundry*, the opinion states that the defendant "made four demonstrably false statements" about its actions during discovery. In *TAUC*, the opinion pointed to the defendant's broken promises to comply with discovery orders and false assertion that the plaintiff never asked to inspect records onsite (he did).

In the end, inspection was ordered and fees were shifted. Both decisions reflect the Delaware Chancery Court's latest efforts to discourage what it sees as a "trend" of bad faith litigation strategies for frustrating inspection demands. Mere delay in the production of documents may not be enough to justify shifting fees, particularly where the company provides the documents, as another recent books-and-records decision held. But litigating plainly legitimate inspection requests, taking overbroad privilege positions, and misrepresenting the record to the Court may be seen as bad faith that comes with a price tag.

Delaware Chancery Court Awards Only Nominal Damages When an Unfair Process Resulted in a Fair Price

Under Delaware law, in transactions where a stockholder with voting control of an entity uses that control to influence a transaction against the interests of minority stockholders, that conflicted controller must demonstrate that the transaction was entirely fair to minority stockholders. If not, the controller has breached the fiduciary duty of loyalty, for which

damages, if any, may be awarded. The two-pronged inquiry considers the fairness of both the process and the price. [*In re Straight Path Commc'ns Consol. Stockholder Litig.*](#) (Del. Ch. Oct. 3, 2023) illustrates a controller's failure to meet the entire fairness standard. The Delaware Chancery Court held that the controller breached his fiduciary duties because the process followed to influence a transaction by coercing a special committee was deemed unfair but awarded only nominal damages to the minority stockholders because the transaction price was deemed to be fair.

Howard Jonas and his family held 75% of the voting power of IDT Corporation, a Delaware public company. In 2013, IDT spun off Straight Path Communications Inc. to hold intellectual property (IP) assets that could potentially be used in respect of patent infringement litigation and a portfolio of broadband spectrum licenses for tax purposes. Stock in Straight Path was distributed *pro rata* to IDT stockholders. Therefore, Jonas became the majority stockholder of Straight Path, and he positioned his son as the Chairman and CEO and recruited three outside directors. IDT and Straight Path entered into a separation and distribution agreement in which IDT indemnified Straight Path for third-party claims incurred prior to the spin-off, provided Straight Path follow the requisite notice provisions in making an indemnification claim.

Per Federal Communications Commission (FCC) regulations, a holder of a spectrum license must demonstrate "substantial service" to the FCC, meaning the ability to broadcast over the spectrum via permanently installed broadcasting equipment. Rather than constructing a permanent installation at each licensed location, IDT allowed a technician to go to the various locations and access the roof, often through bribes, to set up a makeshift handmade radio transmitter built for a mere \$450. After establishing a transmission, the device was promptly removed and used at other locations to demonstrate substantial service. This practice allowed IDT to save millions in costs by flouting the FCC regulations.

Due to the growing demand for broadband spectrum, Straight Path's spectrum licenses, initially viewed as worthless, had become very valuable. Straight Path's stock price more than doubled in 2015, but the gains were compromised when a report was published alleging that IDT had likely committed over 150 counts of fraud on account of the temporary installations. In 2015, the FCC began to investigate Straight Path and IDT. Nevertheless, third parties began to express interest in acquiring Straight Path due to its coveted spectrum licenses, but these offers were contingent on the resolution of the FCC investigation. Therefore, Straight Path entered into a settlement with the FCC in which it agreed to (1) pay \$15 million, (2) give up 196 spectrum licenses for termination, and (3) forfeit 20% of the proceeds from the sale of the remaining spectrum licenses.

While the independent directors of Straight Path considered seeking indemnification from IDT for the FCC penalties incurred on account of IDT's illicit pre-spin-off conduct, they did not formally follow through. Instead, a special committee determined to try to preserve the indemnification claim as a stockholder asset after the sale of the company to an acquirer. Their rationale was to ensure that stockholders received fair value for the indemnification claim because they believed an acquirer would undervalue the claim. Dissatisfied, Jonas used his controlling position to influence the committee to release its potential indemnification claim in exchange for \$10 million in settlement. Jonas exploited his voting control to lead the committee to believe that his support for the sale to an acquirer was conditional on first resolving the indemnification conflict. After settlement, Straight Path sold its IP assets back to Jonas and retained only the spectrum licenses. Straight Path was then acquired by Verizon for \$3.1 billion after a fierce bidding war with a competitor.

Applying the entire fairness standard of review, the Delaware Chancery Court first held that Jonas failed to demonstrate that the process was fair. The record showed that he "made every effort to bully the special committee towards his desired outcome," which included incessant phone calls and verbal abuse. He was found to have created the belief that he

In Delaware, a fair price does not ameliorate an unfair process, but a fair price may ensure that despite a breach of a controller's fiduciary duties, only nominal damages are awarded.

would prevent a sale of the company to attain the release of the indemnification claim. Therefore, the Court found that he settled the indemnification claim in an unfair manner in breach of the fiduciary duties he owed to minority stockholders.

Next, the Court found that the \$10 million that Jonas paid for the indemnification claim was within the range of fairness. While indemnifiable loss had occurred from IDT's pre-spin-off conduct, the notice requirements to seek indemnification were not met because Straight Path failed to promptly notify IDT in writing of the FCC action and alleged claim, which the Court found materially prejudiced IDT. Therefore, the indemnification claim was deemed to have no value, and the \$10 million paid for it was not unfair, because it was higher than what Straight Path could otherwise obtain for it.

In assessing damages, the Court determined what a reasonable sale process for a release of the indemnification claim would have achieved had the process been fair. The Court reiterated that "fair price does not ameliorate a process that was beyond unfair," quoting *In re Tesla Motors Stockholder Litig.* (Del. Ch. Apr. 27, 2022). In further analyzing whether the \$10 million paid was fair, the Court assessed the facial value of a potential successful indemnification claim, then adjusted the amount downward to account for expenses that would be incurred in litigating the claim and other claim-dispositive risks. The Court arrived at a risk-adjusted value of approximately \$8.4 million, which was less than what Jonas paid. This meant that no damages resulted from the coerced settlement and that the price paid was fair. So even though the Court held that Jonas breached his duty of loyalty, it ordered him to pay only nominal damages because, given the fair price, the minority stockholders did not suffer any damages on account of Jonas' bullying and coercion.

A fair price does not ameliorate an unfair process, but a fair price may ensure that despite a breach of a controller's fiduciary duties, only nominal damages are awarded. Nevertheless, to avoid potential litigation and ensuing liability, the importance of satisfying both elements of the entire fairness standard has been reiterated, underpinning a fair process that is free of coercion from a controller—and fair price. *In re Straight Path* also highlights the importance of complying strictly with notice provisions in agreements, ensuring that notice is timely, given formally such as in writing, and phrased appropriately to have the effect of placing the receiving party on notice.

U.S. Supreme Court to Decide Whether a Private Right of Action Exists for Deficient MD&A

On September 29, 2023, the U.S. Supreme Court granted certiorari in *Macquarie Infrastructure Corp. v. Moab Partners, L.P.* to review a decision by the Second Circuit reviving an investor lawsuit alleging Section 10(b) and Rule 10b-5 violations predicated on a failure to make disclosures required under Item 303 of Regulation S-K. Among other things, Item 303 requires companies to disclose "any known trends or uncertainties that have had or that are reasonably likely to have a material favorable or unfavorable impact" on their financial performance. Item 303 does not explicitly provide a private right of action for investors to sue if these disclosure requirements are not met; it only serves as the basis for an SEC enforcement action. However, private investors are able to sue companies for material misstatements or omissions in their disclosures under Section 10(b) of the Securities Exchange Act of 1934 (Exchange Act) and Rule 10b-5 thereunder, which makes it unlawful for a company to make an untrue statement or omit a material fact "necessary" to make an affirmative statement "not misleading." However, the federal courts are currently split on whether Item 303 creates an affirmative duty of disclosure that is sufficient to establish liability under Section 10(b) and Rule 10b-5: the Second Circuit has held that Item 303 does create an actionable duty of disclosure, while the Ninth, Third, and Eleventh Circuits have held that it does not. For more details about the case history and the circuit split, please see the Sidley blog post [here](#).

A decision by the U.S. Supreme Court to allow MD&A line-item omissions to serve as a basis for Section 10(b) liability could have a significant impact on private securities fraud litigation.

A decision to allow management discussion and analysis (MD&A) line-item omissions to serve as a basis for Section 10(b) liability could have a significant impact on private securities fraud litigation. This has the potential to expand the private right of action under Section 10(b) and Rule 10b-5 to more closely resemble Section 11 and 12(a)(2) liability for omissions of “a material fact required to be stated.” This change would enable plaintiffs to establish a duty to disclose when they otherwise may not be able to plead an omission case. In addition, the ruling may raise questions about whether other disclosure obligations under Regulation S-K should be afforded similar treatment (e.g., cybersecurity and pending climate change disclosure rules). Argument is scheduled for mid-January 2024. Companies should remain apprised of developments in this case and, in any event, continue to diligently review their MD&A disclosures for accuracy and completeness.

CORPORATE GOVERNANCE DEVELOPMENTS

Glass Lewis Proxy Voting Policy Updates for 2024

Glass Lewis & Co. has updated its [proxy voting policies](#) for stockholder meetings held on or after January 1, 2024. This is a brief summary of the most noteworthy changes Glass Lewis made to its proxy voting policies that apply to U.S. companies.

- **Material Weaknesses.** Under a new policy, when a material weakness is reported and the company has not disclosed a remediation plan, or when a material weakness has been ongoing for more than one year and the company has not disclosed an updated remediation plan that clearly outlines the company’s progress toward remediating the material weakness, Glass Lewis will consider recommending that stockholders vote against all audit committee members who were serving on the committee when the material weakness was identified.
- **Cyber Risk Oversight.** In instances where cyberattacks have caused significant harm to stockholders, Glass Lewis will closely evaluate the board’s oversight of cybersecurity as well as the company’s response and disclosures. Where “a company has been materially impacted by a cyber-attack,” Glass Lewis believes companies should provide periodic updates to their stockholders on the “ongoing progress towards resolving and remediating the impact of the cyber-attack,” and Glass Lewis may recommend voting against appropriate directors if it finds that the board’s oversight, response or disclosures concerning cybersecurity-related issues are absent or insufficient.
- **Board Oversight of Environmental and Social (E&S) Issues.** Consistent with its 2023 policy, Glass Lewis will generally recommend voting against the governance committee chair at a Russell 1000 company that does not explicitly disclose the board’s role in oversight of E&S issues. In its updated policy, Glass Lewis stated its view that companies should formally codify in the applicable committee charter or other governing document where the board responsibility for overseeing E&S risk sits. When evaluating the board’s role in overseeing E&S issues, Glass Lewis will examine a company’s committee charters and governing documents to determine whether the company has codified a meaningful level of oversight of and accountability for a company’s material E&S impacts.
- **Board Accountability for Climate-Related Issues.** Glass Lewis expanded the list of companies subject to its policy on board accountability for climate-related issues. Instead of applying only to the largest, most significant emitters, beginning in 2024, Glass Lewis will apply this policy to (1) S&P 500 companies in industries where the Sustainability Accounting Standards Board has determined that greenhouse gas emissions represent a financially material risk and (2) companies to which it believes emissions or climate impacts, or stakeholder scrutiny thereof, represent an outsized, financially material risk.

Glass Lewis believes a company that has been materially impacted by a cyber-attack should provide periodic updates to its stockholders on the ongoing progress towards resolving and remediating the impact of the cyber-attack. Glass Lewis may recommend voting against appropriate directors if it finds that the board’s oversight, response or disclosures concerning cybersecurity-related issues are absent or insufficient.

Glass Lewis will assess whether such companies have produced disclosures in line with the recommendations of the Task Force on Climate-related Financial Disclosures. Glass Lewis further clarified that it will assess whether these companies have disclosed explicit and clearly defined board-level oversight responsibilities for climate-related issues. In instances where it finds either of these disclosures to be absent or significantly lacking, Glass Lewis may recommend voting against responsible directors (generally, the chair of the committee charged with oversight of climate-related issues, or if there is no such committee, the governance committee chair).

- *Clawback Policies.* Glass Lewis believes that effective clawback policies should provide companies with the power to recoup incentive compensation from an executive in cases of problematic decisions or actions, such as material misconduct, material reputational failure, material risk management failure, or material operational failure. If a company does not follow through with recovery, Glass Lewis will expect and assess a “thorough, detailed discussion of the company’s decision not to pursue recoupment and, if applicable, how the company has otherwise rectified the disconnect between executive pay outcomes and negative impacts of their actions on the company.” The absence of this disclosure may impact Glass Lewis’s recommendation on the say-on-pay vote.
- *Executive Stock Ownership Guidelines.* To promote alignment between the long-term interests of executive leadership and stockholders, Glass Lewis advises companies to adopt and enforce minimum executive stock ownership policies. Further, companies should provide clear disclosure in the compensation discussion and analysis of their executive stock ownership requirements and how various outstanding equity awards are treated when determining an executive’s level of ownership. According to Glass Lewis, neither unearned performance-based awards nor unexercised stock options should be counted toward an executive’s minimum ownership without explanatory rationale.
- *Board Responsiveness.* Glass Lewis clarified that its policy with respect to circumstances where “20% or more of stockholders vote contrary to management” does not apply to votes for a stockholder proposal and also clarified that “voting contrary to management” means votes cast as “against” or “abstain.” However, note that Glass Lewis’s board responsiveness policy still applies to majority-supported stockholder proposals.
- *Interlocking Directorships.* Glass Lewis noted that it will evaluate, on a case-by-case basis, other types of interlocking relationships, such as interlocks with close family members of executives or within group companies. Further, Glass Lewis will evaluate multiple board interlocks among non-insiders (*i.e.*, multiple directors serving on the same boards at other companies) for evidence of a pattern of poor oversight. The interlock policy applies to both public and private companies.
- *Board Gender and Underrepresented Community Diversity.* Glass Lewis clarified that when making voting recommendations based on board diversity (or lack thereof), Glass Lewis will review a company’s disclosure of its diversity considerations and may refrain from recommending votes against directors when boards have provided a sufficient rationale or plan to address the lack of diversity on the board, including a timeline (generally by the next annual meeting or, new for 2024, as soon as reasonably practicable) of when the board intends to appoint diverse directors.

SEC DEVELOPMENTS

New Guidance on Requesting Delayed Reporting of Cybersecurity Incident Disclosures for National Security or Public Safety Reasons

As of December 18, 2023, public companies must disclose a material cybersecurity incident under Item 1.05 of Form 8-K within four business days of determining that the incident is

material. There is a limited exception to the filing deadline if the U.S. Attorney General provides a written determination to the SEC that immediate disclosure would pose a substantial risk to national security or public safety. Such exception may delay reporting by 30 or 60 days and can be renewed. In advance of the effective date of the new disclosure requirement, the DOJ, Federal Bureau of Investigation (FBI), and SEC provided helpful guidance on how companies that have experienced cybersecurity incidents may request a reporting delay for national security or public safety reasons.

The DOJ issued guidelines titled [Department of Justice Material Cybersecurity Incident Delay Determinations](#) that describe the process a company may use to request a delay and the procedures the Attorney General will use to assess whether a delay is warranted. According to the DOJ guidelines, if a company discovers a cybersecurity incident and believes that disclosure may pose a substantial risk to national security or public safety, the company should, directly or through another U.S. government agency, immediately contact the FBI, which the DOJ has made responsible for intaking delay requests. The FBI released [guidance](#) providing further details as to how companies that have experienced cybersecurity incidents may request a reporting delay on the basis of national security or public safety concerns. That guidance specifies 10 pieces of information that a delay request must contain and encourages public companies to “establish a relationship with the cyber squad at their [local FBI field office](#).” The FBI also published a [policy notice](#) that describes how it plans to process and respond to delay requests.

In mid-December 2023, the SEC issued guidance in the form of [four new compliance and disclosure interpretations](#) (CDIs) about delayed reporting of material cybersecurity incidents. Most notably, the CDIs make clear that requesting a delay does not change the timing of the company’s filing obligation—a company may delay providing the Item 1.05 Form 8-K disclosure only if the Attorney General determines that disclosure would pose a substantial risk to national security or public safety and notifies the SEC of the determination in writing before the Form 8-K filing deadline. The CDIs also explain that just because a company consults with the DOJ, FBI, or Cybersecurity & Infrastructure Security Agency (CISA) regarding a delay does not automatically signify that the cybersecurity incident in question is material.

On December 14, 2023, Erik Gerding, Director of the SEC’s Division of Corporation Finance, released a [speech](#) on cybersecurity disclosure. To address a potential misconception, Gerding emphasized that the SEC is not seeking to prescribe specific cybersecurity practices, risk management, governance, or strategy and that public companies have the discretion to choose how to address cybersecurity risks based on their particular facts and circumstances. Further, he highlighted an instruction in the final rule explaining that companies are not expected to disclose specific technical information about their cybersecurity systems or planned response that could impede remediation of a cybersecurity incident or provide a road map that threat actors could exploit for future attacks. He also reiterated that the deadline for cybersecurity incident disclosure is within four business days after the company determines the incident to be material—not four business days after the incident occurred or is discovered. Gerding encourages companies to work with the FBI, CISA, and other law enforcement and national security agencies as early as possible after a cybersecurity incident occurs, explaining that early outreach may help companies with determinations regarding materiality and whether to seek a reporting delay from the DOJ. Finally, Gerding reassured companies that in this first year of required disclosure, the Division does not intend to make “gotcha” comments or penalize foot faults but may issue forward-looking comments to companies or additional CDIs, as appropriate.

Public companies should review the new guidance from the DOJ, FBI, and SEC, including the process and timing and content requirements for delay requests, and consider making corresponding updates to their incident response plans and related processes. As a

Requesting a delay does not change the timing of the company’s filing obligation—a company may delay providing the Item 1.05 Form 8-K disclosure only if the Attorney General determines that disclosure would pose a substantial risk to national security or public safety and notifies the SEC of the determination in writing before the Form 8-K filing deadline.

practical matter, it may still be difficult for public companies to obtain a written determination from the Attorney General before the Form 8-K filing deadline, but early engagement with the relevant governmental authorities may prove advantageous.

SEC Adopts Amendments to Rules Governing Beneficial Ownership Reporting, Accelerating the Deadlines for Schedule 13D and 13G Filings

In October 2023, the SEC adopted certain of its proposed changes to the rules governing beneficial ownership reporting under Sections 13(d) and 13(g) of the Exchange Act and issued guidance in lieu of adopting certain other proposed rules. These amount to the most significant changes in beneficial ownership filing requirements in approximately the past 50 years.

The amendments shorten the deadlines for initial and amended Schedule 13D and 13G filings, as summarized in the table of the Sidley Update [here](#). Some notable changes from the proposed rules include (1) requiring Schedule 13D amendments to be filed within two business days, as is market standard (instead of one business day, as proposed), and (2) requiring the current “annual” Schedule 13G amendments to be filed within 45 days of any quarter end (instead of within five business days of each month end, as proposed).

The amendments also:

- extend the filing deadline from 5:30 p.m. ET to 10 p.m. ET (same deadline as for Section 16 filings)
- clarify that cash-settled derivative securities, including total return swaps, are required to be disclosed in Item 6 of Schedule 13D
- impute acquisitions by group members to the group at any time after the group has been formed (excluding intragroup transfers of securities)
- require that Schedule 13D and 13G filings be made using a structured, machine-readable data language

Compliance with the final rule amendments, including the accelerated Schedule 13D filing deadlines, will be required when the amendments take effect on February 5, 2024, subject to two exceptions: Compliance with the revised Schedule 13G filing deadlines will be required beginning September 30, 2024, and compliance with the machine-readable format requirements for Schedules 13D and 13G will be required beginning December 18, 2024.

While the changes in filing deadlines are modest, under the new regime, companies will be able to see more quickly which investors are increasing their positions compared to the prior regime. For a more fulsome summary of the rule amendments and related guidance, see the Sidley Update [here](#).

SEC Settles Charges for Alleged Internal Accounting Controls Violations Related to Stock Buybacks

In November 2023, the SEC announced a settled action against a public company for allegedly “violating internal accounting controls requirements when it engaged in stock buybacks not authorized by its board of directors.” More specifically, the board of directors had authorized the company to conduct stock buybacks using Rule 10b5-1 plans, but according to the SEC’s order, from 2017 to 2021, the company used plans that included “accordion” provisions that would increase the amount of stock repurchases if the company conducted debt offerings that included buybacks as a permitted use of proceeds. Because the company had discretion over whether and when to conduct the debt offerings, the SEC concluded that the company did not meet the conditions of Rule 10b5-1 and thus did not act within the board’s authorization. According to the SEC’s order, the company’s repeated

While the revised deadlines will increase compliance costs and, particularly for Schedule 13G filers, will result in a significant increase in the number of filings required to be made, they are far more workable than those originally proposed by the SEC.

use of trading plans that did not conform to Rule 10b5-1 was the result of insufficient internal accounting controls, in particular, the absence of reasonably designed controls to analyze whether the discretion the accordion provisions gave executives to alter the company's trading was consistent with the board's authorizations.

Although the SEC concluded that the company did not satisfy the Rule 10b5-1 affirmative defense, the SEC's action was not grounded on insider trading or fraud. The SEC instead found the company to be in violation of Exchange Act Section 13(b)(2)(B), concluding that the company's failure to conduct its stock buybacks in accordance with the board's instruction to use Rule 10b5-1 plans was the result of a lack of internal accounting controls. Without admitting or denying the findings in the order, the company agreed to cease and desist from further violations of Section 13(b)(2)(B) and pay a civil penalty of \$25 million. In a dissenting opinion, SEC Commissioners Hester Peirce and Mark Uyeda said the SEC attempted to turn the internal accounting controls provision of Section 13(b)(2)(B) into "an ever-unfolding utility tool that magically converts every corporate activity into something the Commission regulates."

Given the SEC's expansive interpretation of the internal accounting controls provision of the Exchange Act, public companies should ensure that board resolutions are carefully drafted so that the parameters are clear and provide sufficient latitude to implement the actions authorized thereby. They should also have policies and procedures in place for confirming that trading plans to be used for stock repurchases are consistent with the authorizing resolutions and Rule 10b5-1, if applicable.

SEC Releases Fall 2023 Rulemaking Agenda with Plans to Finalize Climate Change Disclosure Rules by April 2024

In December 2023, the SEC released its Fall 2023 rulemaking [agenda](#) announcing its plans to act on several key rulemakings in the next few months. Most notably, the SEC further delayed final action on the [climate change disclosure rules](#). The SEC now plans to adopt the final rules by April 2024; they were originally slated to be finalized by April 2023 and then October 2023. The SEC is also now targeting April 2024 as the time by which to finalize the rules on [SPACs](#) and [shareholder proposals under Rule 14a-18](#) (each deferred from October 2023).

The SEC expects to propose rules on [human capital management disclosure](#) by April 2024 (deferred from April 2023 and then October 2023). SEC Chair Gary Gensler has indicated that a human capital management disclosure proposal could include disclosure of information such as metrics, workforce turnover, skills and development training, compensation, benefits, and workforce demographics that include diversity, as well as health and safety. Finally, plans to propose a rule enhancing [corporate board diversity disclosures](#) were extended from April 2024 to October 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 that 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

The SEC's adoption of final rules on climate change disclosures has been a moving target, and according to the Fall 2023 Reg-Flex Agenda released on December 6, 2023, the SEC now expects to adopt the final rules by April 2024.

analysis to prepare for the new disclosures and evaluating existing climate-related risks, targets, and goals in light of the potential new disclosure requirements. While the rules pertain only to disclosures, they will impact operations by indirectly requiring companies to take action, to the extent they are not already doing so, to put monitoring, accounting, planning, and governance practices in place to enable them to satisfy the disclosure requirements. Regardless of whether the SEC implements the proposed rules and in what form, proxy advisory firms and institutional investors are demanding more disclosure regarding ESG matters including information regarding climate-related governance, risks, and metrics.

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

Anti-Money Laundering

[Updates on U.S. Corporate Transparency Act Beneficial Ownership Reporting](#) (December 14, 2023). Beneficial ownership information (BOI) reporting requirements under the Corporate Transparency Act (CTA) and the related final rule (BOI Rule) adopted by the Financial Crimes Enforcement Network (FinCEN) will go into effect on January 1, 2024. The CTA and BOI Rule require certain domestic and foreign entities doing business in the U.S. to file reports with FinCEN identifying and providing information about their beneficial owners and company applicants. The BOI Rule includes 23 categories of exemptions from the definition of "reporting company" from the CTA for entities already generally subject to substantial U.S. federal or state regulation under which beneficial ownership may be known, including for public companies registered with the SEC. FinCEN has also recently adopted certain amendments in connection with the BOI Rule. Companies doing business in the U.S. should take note of these pending reporting obligations, including certain material ambiguities that remain subject to FinCEN clarification.

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.

[November Antitrust Bulletin](#) (November 29, 2023). The FTC recently filed a [petition](#) and [supporting memorandum](#) in district court in the Eastern District of Virginia to enforce a civil investigative demand against a third party in an ongoing price discrimination investigation under the Robinson-Patman Act. The FTC sued to block a hospital merger, alleging that the transaction would lessen competition for general acute healthcare services, leading to higher rates for insurers and lower-quality care. The DOJ filed a [consent decree](#) in the agricultural sector preventing so-called *de facto* noncompete clauses. In the EU, the German competition authority's powers related to sector inquiries were bolstered as a result of [amendments](#) to the German Competition Act, allowing general investigations into whether competition in a sector is working, as opposed to investigations into whether particular companies have broken the law. In the United Kingdom (UK), on October 30, 2023, the Competition and Markets Authority (CMA) published [prioritization principles](#) for its work after receiving support from businesses and consumer bodies during a consultation period.

[October Antitrust Bulletin](#) (October 26, 2023). The UK CMA recently issued guidance setting out its policy for environmental sustainability agreements. The DOJ focus on information exchanges continued, as it filed a complaint against a consulting firm engaged in benchmarking. The FTC interest in labor issues was advanced as it entered into a memorandum of understanding with the Department of Labor that sets out how the two agencies plan to work together to promote competition in labor markets. The European Commission prohibited a proposed acquisition deal because it would allegedly improve the acquirer's existing dominant position.

[September Antitrust Bulletin](#) (September 26, 2023). The European Commission designated the first set of platforms with "gatekeeper" status under the EU Digital Markets Act. The DOJ continued its initiative to assess AI and its impact on competition. Similarly, the UK CMA proposed principles to guide AI foundations models that aim to ensure consumer protection and healthy competition. The DOJ trial against Google for monopolization in the search space commenced in the U.S. District Court for the District of Columbia.

Artificial Intelligence

[President Biden Signs Sweeping Artificial Intelligence Executive Order](#) (November 6, 2023). On October 30, 2023, President Joe Biden issued the [Executive Order on Safe, Secure, and Trustworthy Development and Use of Artificial Intelligence](#). Its objective is to advance a coordinated, federal governmentwide approach toward the safe and responsible development of AI. It imposes premarket testing and reporting requirements on certain AI developers. It sets forth a wide range of federal regulatory principles and priorities and directs myriad federal agencies to promulgate standards and technical guidelines over the next year to make AI more secure, cementing U.S. leadership in global AI policy. Several sectoral regulatory authorities, including the Departments of Commerce, Energy, Health and Human Services, Homeland Security, Transportation, and Education as well as the Copyright Office and U.S. Patent and Trademark Office, are directed to address risks and potential benefits from the use of AI in financial services, healthcare, biotechnology, energy, transportation, telecommunications, intellectual property, competition, labor, education, housing, law enforcement, consumer protection, cybersecurity, national security, privacy, and trade. Companies should closely monitor activity from the various regulators over the next several months to determine new obligations.

ESG

[California Enacts Landmark Climate Accountability Package Requiring Expansive Disclosure of Climate-Related Risks](#) (October 10, 2023). California Democratic Gov. Gavin Newsom signed into law landmark climate disclosure and financial reporting legislation: the [Climate Corporate Data Accountability Act](#) and the [Climate-Related Financial Risk Act](#). These new laws impose broad unprecedented greenhouse gas reporting requirements on large U.S. public and private companies doing business in California and require reporting of climate-related financial risks. The definition of "doing business" in California includes companies actively engaging in any transaction for the purpose of financial or pecuniary gain or profit within California. Therefore, these laws effectively set a national standard for business to disclose information on greenhouse gas emissions and have the potential to reach every part of a company's value chain.

Labor and Employment

[Attention Employers: New California Employment Laws Have Arrived](#) (October 31, 2023). California Gov. Newsom signed into law several employment-related bills that have far-reaching implications for employers (and their HR teams tasked with administering changes). The employment-related laws concern privileged communications in the context of workplace harassment/discrimination, prohibitions on noncompete agreements, elimination

of automatic stays and arbitration, establishment of a rebuttable presumption of retaliation, an increase in minimum paid sick leave, prohibitions on marijuana-use discrimination, and unpaid leave for reproductive loss. The laws become effective January 1, 2024, and employers should review their policies and practices now to be sure they are prepared to address these changes.

SEC Disclosure and Enforcement

[U.S. SEC Division of Enforcement Reports Increase in Actions and High Recoveries in 2023 Fiscal Year](#) (November 28, 2023). On November 14, 2023, the Enforcement Division (Division) of the SEC released its annual [report](#), which detailed the agency's enforcement efforts during its 2023 fiscal year. The Division reported that it brought a total of 501 standalone actions, an 8% increase over 2022. The total number of enforcement actions also increased 3% from the prior year at 784 total actions. Although still down from pre-Covid years, the numbers have steadily increased in recent years. The Division also reported the second-highest number of monetary recoveries in SEC history following record-breaking numbers in 2022, totaling nearly \$5 billion in civil penalties, disgorgement, and pre-judgment interest in 2023. The Division emphasized the benefits of cooperation, noting that it did not impose civil penalties, or agreed to substantially limit penalties, in a number of actions where companies self-policed, self-reported, cooperated meaningfully with the staff's investigation, and/or undertook remedial measures.

[SEC's Cybersecurity Disclosure Rules Are Here. Is Your Company Ready to Comply?](#) (September 2023). In this episode of the Sidley Podcast, Sidley partner host Sam Gandhi speaks with Sonia Barros, a partner in Sidley's Capital Markets group and co-leader of the firm's Public Companies practice, and Colleen Brown, a partner in the firm's practices in Privacy and Cybersecurity, Commercial Litigation and Disputes, Crisis Management and Strategic Response, and Insurance. They discuss the SEC's newly adopted regulations for disclosing information on cyber risk and how companies and their boards can best comply. Companies are facing more attacks on their information systems and as their cyber risk skyrockets, the SEC has stepped in with new regulations, telling businesses what to disclose about these incidents and requiring detailed disclosures on cyber risk management more broadly. In light of the December 2023 deadline for compliance, businesses are scrambling to mitigate their legal risk and comply with regulations that some say may be an overreach.

Supreme Court of the United States (SCOTUS)

[How the Cases Before the Supreme Court Could Impact You and Your Business](#) (October 2023). In this episode of the Sidley Podcast, Sidley partner host Sam Gandhi is joined by Kwaku Akowuah and Rob Hochman, co-leaders of Sidley's Supreme Court and Appellate practice, to discuss the monumental cases decided by SCOTUS last term, upcoming cases the business community should know about, and current issues facing of the Court. After its seismic decisions last term, SCOTUS has set its sights on another slate of high-stakes cases that could again transform elections, policy, and public life. On the docket are the First Amendment, gun rights, racial gerrymandering, and the power of the executive branch over regulation. Companies are bracing for decisions that could impact the way they do business, while the Court faces controversy over its ethics and indeed its legitimacy.

White Collar: Government Litigation and Investigations; Corporate Compliance

[Key Takeaways from DOJ's New "Mergers & Acquisitions Safe Harbor" Policy for Companies that Self-Report Misconduct](#) (October 6, 2023). On October 4, 2023, the DOJ announced an M&A Safe Harbor Policy for companies that voluntarily and timely self-report misconduct discovered during the due diligence of an acquisition target or the integration of the acquired entity. It is designed to offer substantial benefits, including the presumption of a declination of prosecution to companies that self-report misconduct within six months of a

transaction closing—regardless of whether the misconduct was discovered pre- or post-acquisition. The policy reiterates the importance of acquiring companies having a robust due diligence and post-closing integration process in place that is reasonably designed to detect potential violations of law, which positions an acquirer to assess the risks and the possible substantial benefits of timely self-disclosing misconduct to the DOJ. Conversely, target companies should note that failure to implement compliance controls could lead to liability that will be uncovered and disclosed by an acquirer before or even after a transaction closes.

SIDLEY SPEAKERS

M&A Trends and Developments

January 23, 2024 | Coronado, CA

Northwestern Pritzker School of Law will host its 51st annual Securities Regulation Institute in Coronado, California on January 22-24. One of the most visible and highly regarded securities and corporate law conferences in the country, the Securities Regulation Institute reaches prominent attorneys from both firm and in-house practices. On January 23, Sharon Flanagan, a partner in Sidley's San Francisco and Palo Alto offices, will chair a session titled *M&A Trends & Developments*. Click [here](#) for more information.

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