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ANALYSIS

STRATEGIC MINORITY INVESTMENTS IN PUBLIC COMPANIES PROVIDE PATHWAY TO VALUE-BASED DEALMAKING

By Pran Jha, Joe Michaels, Jack Melamed, and Liz Buescher[1]

Dollar value and deal volume are not the only M&A measures that fluctuate when markets waver. As headwinds gather, dealmakers flock to creative types of transactions that are suited to the circumstances and involve manageable risk levels. In recent years, targeted strategic investments in public companies have again risen to prominence in response to market uncertainty. Prominent examples include State Farm's and Google's respective investments in ADT (2022 and 2020), PepsiCo's investment in Celsius (2022), and Cigna's investment in Bright Health (2021).

Strategic minority investments can serve as an advantageous way to deploy or raise capital and enhance shareholder value in both uncertain and favorable economic environments, providing a unique value proposition together with a circumscribed, agile, and efficient pathway to pursuing deals.

These transactions — which generally involve strategics (rather than institutional, private equity, or other financial investors) acquiring between 5% and 40% of a public company's stock on a friendly basis — can serve as an advantageous way to deploy or raise capital and enhance shareholder value for both the investor and the target company.[2] As valuations fluctuate, financing markets tighten, regulatory scrutiny increases, and economic confidence wanes, these investments provide a circumscribed, agile, and efficient pathway to pursuing deals. But these strategic minority investments are not only suited for uncertain times; they can provide a unique value proposition in favorable economic environments as well. In many instances, these investments involve not only a financial investment coupled with typical corporate governance rights and obligations but also include accompanying commercial, development, or similar arrangements that can be drivers of growth for both parties.

Sophisticated dealmakers keep strategic minority investments in their toolkit for all markets, and when structured and negotiated carefully, they can result in compelling opportunities. Investors and target companies that are well prepared and well advised with respect to the relevant issues can position themselves to execute on these opportunities when they arise.

Key Features of Strategic Minority Investments

Strategic minority investments in public companies involve a range of M&A, public company, and commercial legal considerations.

Investment Structure. Strategic minority investments are typically structured as primary issuances of either common or preferred stock by the target company to the investor. Most of these transactions are completed as private placements exempt from registration with the Securities and Exchange Commission (SEC) under Rule 506 of Regulation D. However, if that is not available, then the parties will either need to rely on another private placement exemption or register the offering and sale of securities. Other alternatives exist, including structures involving secondary stock sales from existing investors (either directly or through a public tender offer) and stock repurchases by the target company.

Valuation. The per-share pricing of a minority investment in a publicly traded company is subject to the market trading price, valuation analyses, and negotiation. It is not typical to see the types of control premiums that are prevalent in change-of-control transactions. Pricing at or around a weighted average market price (sometimes with a discount) is not uncommon. Among the benefits to the target company is a potential signal to the trading markets sent by an investment by a sophisticated market participant at a favorable valuation. As in all significant transactions, the target company's board of directors must engage in a

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2 For purposes of this article, we distinguish between strategic minority investments and private investments in public equity (PIPE transactions), which are often undertaken by institutional, private equity, and other financial investors in a variety of circumstances involving, among other things, distressed or special purpose acquisition companies (SPACs).

robust and careful evaluation process with appropriate financial and legal advisors to satisfy its fiduciary duties.

Transaction Terms. The stock purchase agreement governing a strategic minority investment typically contains provisions similar to those customarily included in agreements governing public company mergers. However, certain areas are likely to be streamlined and otherwise modified to reflect the nature of the transaction. Parties can expect basic mechanical provisions providing for the consummation of the investment, representations and warranties (with a limited survival period, if any), limited traditional indemnification obligations (if any), pre-closing covenants, closing conditions, and termination rights. Although much less common, the purchase agreement might also include termination fees, no-shop provisions, and similar deal protection provisions.

Shareholder and Regulatory Approvals. It is important to analyze any required shareholder approvals and related timing implications, with particular consideration given to stock exchange and other rules applicable to stock issuances. In addition, parties must determine whether the transaction is subject to any U.S. or foreign antitrust, foreign direct investment, or other regulatory regimes, particularly in a climate of increased regulatory scrutiny.

Some strategic minority investments include a commercial, development, or similar arrangement between the investor and the target company that may serve as a potential source of value and collaborative partnership beyond the financing and earnings growth objectives of the standalone investment.

Corporate Governance Rights and Obligations. In an investment involving a meaningful minority stake, parties typically provide for corporate governance terms beyond those set forth in the target company's organizational documents. The governance arrangements will depend on the particular circumstances, such as the deal size and dynamics and the relationship between the parties. Potential options include providing the investor with information and observer rights and one or more seats on the target company's board of directors (while being mindful of fiduciary duty, confidentiality and prohibited interlocking directorate considerations) and subjecting the investor to certain voting obligations and standstill restrictions (including limitations on additional stock purchases and unsolicited offers, proxy contests, and other hostile actions to ensure control of the target company is not transferred without payment of an appropriate control premium, among other things). If the target company has already entered into similar agreements with existing investors, careful consideration will need to be given to confirm that the strategic minority investment does not conflict with those arrangements.

Liquidity and Exit Terms. The investor will focus on its ability to sell the purchased stock in the future. Whether or not the investor is deemed an "affiliate" of the target company, and mindful of the conditions required to utilize the "safe harbor" exemption under Rule 144 under U.S. securities laws, the investor may want to negotiate for registration rights to facilitate future sales of its stock. However, the target company will want to ensure that any sales occur in an orderly manner that does not disrupt the trading market for its stock or its ability to raise capital. The target company may sometimes seek transfer restrictions that expire or phase out upon specified deadlines or milestones (*e.g.,* ownership below a certain threshold).

Commercial Arrangement. Some strategic minority investments include a commercial, development, or similar arrangement between the investor and the target company. Such an arrangement may serve as a potential source of value and collaborative partnership beyond the financing and earnings growth objectives of the standalone investment. These arrangements can take a number of forms, including supply, distribution, licensing, marketing, co-location, collaboration, or research and development agreements. In some instances, the source of funding for the arrangement may be the investment itself, or there may be scope and duration interplay with the investment.

Public Disclosure Obligations. Strategic minority investments involve important public disclosure implications under U.S. securities laws, possibly for both parties. The target company—and, if a public company itself, the investor—may be required to make disclosures on Form 8-K regarding the investment and definitive transaction documentation. Following the closing, both parties and certain affiliated persons may be required to make various disclosures pertaining to stock ownership and other matters on an ongoing basis. In particular, investors may be required to report their ownership on Schedule 13D if active (*e.g.*, have a board seat) or Schedule 13G if passive, as well as on amendments thereto as required. Further, if the investor beneficially owns more than 10% of any class of registered securities, the investor will be subject to Section 16 reporting requirements and short-swing profit prohibitions.

Communications and Investor Relations. A well-organized communications rollout including a cohesive explanation of the strategic rationale for the transaction is critical to ensure a positive reaction from shareholders and business partners, employees, and other stakeholders. In particular, parties can expect that the announcement may trigger discussion about the investor's potential influence over management and the likelihood of a subsequent change-of-control transaction. Where appropriate, it may be useful for the parties to highlight the desire and basis for a long-term partnership. The parties should also address any competitive concerns, if relevant.

A strategic minority investment may offer the investor an opportunity to generate returns on a liquid investment by acquiring stock without a control premium, collecting dividends, enhancing value through collaboration with management, and/or implementing a new or expanded commercial partnership.

Framework for Considering Strategic Minority Investments

Strategic minority investments may be desirable alternatives to change-of-control transactions, joint ventures, standalone commercial agreements, and other types of transactions. A well-structured strategic minority investment can efficiently and effectively combine value drivers from other transaction structures if the investor and the target company are sufficiently aligned on the many components, including investment economics and terms, use of funds, corporate governance, operations, and collaboration.

Specifically, a strategic minority investment may offer the investor an opportunity to generate returns on a liquid investment by acquiring stock without a control premium, collecting dividends, enhancing value through collaboration with management, and/or implementing a new or expanded commercial partnership.

Further, the target company may generate value by accessing a source of capital that can be deployed for growth opportunities or leverage reduction, gaining credibility through an investment by a sophisticated market participant at an attractive valuation, gaining additional perspective from a new investor, and/or participating in a new or expanded commercial partnership, all in a manner consistent with the target company's business plans. In addition, the investment may be completed on an accelerated timeline with less expense and integration risk and more flexible terms and closing certainty as compared to other transaction structures.

Strategic minority investments can offer a compelling value proposition that can be used to solve complex business and legal issues between transacting parties. This makes the structure a useful and pragmatic tool available to companies and dealmakers.

UPDATE YOUR FEE-SHIFTING PROVISION: THE CONTINGENCY FEE TRAP

By Sara Garcia Duran and Sacha Jamal[3]

If a purchase agreement has a fee-shifting provision and the prevailing party hires counsel on a contingency fee basis, does the losing party have to pay the contingency fee? The answer is yes, based on the Delaware Chancery Court's ruling in *The Williams Cos., Inc. v. Energy Transfer LP,* C.A. No. 12168-VCG, 2022 WL 3650176 (Aug. 25, 2022). We look at the court's ruling and suggest a modification to the fee-shifting provision to alter this result. We also offer a drafting tip regarding the calculation of interest.

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If a purchase agreement has a fee-shifting provision and the prevailing party hires counsel on a contingency fee basis, the losing party has to pay the contingency fee under Delaware law, per the Delaware Chancery Court's ruling in The Williams Cos., Inc. v. Energy Transfer LP.

The *Williams* case is based on a dispute over the merger agreement between The Williams Companies, Inc. (Williams) and Energy Transfer LP (ETE). The deal fell through, and the court found that Williams was entitled to a $410 million judgment as liquidated damages, as specified in the merger agreement. Normally, courts follow the American Rule — each litigant pays its own attorneys' fees — but, in this case, the parties had altered that default rule. The merger agreement provided that if Williams prevailed in the recovery of the breakup fee, Williams was entitled to recover its reasonable attorneys' fees and expenses related to such recovery from ETE.

Williams hired its counsel under a contingency fee structure, and the main dispute in this last opinion of the *Williams v. ETE* saga was whether the contingency fee was reasonable.

The Chancery Court concluded that the contingency fee was reasonable in this case. Consequently, ETE had to pay the 15% contingency fee that Williams had agreed to pay to its counsel, Cravath, Swaine & Moore LLP. Two of ETE's failed arguments merit a close review.

First, ETE argued that it was unreasonable for Williams to switch from an hourly arrangement to a contingency fee arrangement mid-litigation. However, the Chancery Court found this was reasonable because the change occurred when the nature of the case shifted from one seeking injunctive relief (which called for a noncontingent representation) to one seeking recovery of the breakup fee (for which contingent representation was a business option). However, the Chancery Court cautioned that a change to a contingency fee arrangement may be unreasonable in some circumstances. For example, if the litigation had progressed significantly or the uncertainty of the outcome had diminished, switching to a contingency fee in an attempt to penalize the other side would be unreasonable.

The Williams *court ruled that the switch from an hourly arrangement to a contingency fee arrangement mid-litigation was reasonable because the change occurred when the nature of the case shifted – but such a switch may be unreasonable in some circumstances.*

Second, ETE argued that Cravath's fee under the contingency fee arrangement ($74.8 million) was unreasonable because it was 1.7 times what Cravath would have received based on a traditional hourly rate ($47.1 million). This disclosure came out because Williams had to provide a "lodestar" — calculated as the number of hours Cravath expended multiplied by its hourly rate — to support the contingency fee. Additionally, ETE complained that the number of hours and the billing rate of Cravath were higher than the number of hours that ETE's counsel billed to the matter and the billing rate of ETE's counsel. However, the Chancery Court held that the 1.7 lodestar multiple was within the range of reasonableness. The Chancery Court also found that the number of hours Cravath expended (which involved Williams having to produce approximately 10 times more documents than ETE) and its billing rates (which reflected a discount and rate freeze and were at a level the market would bear for its services) were both reasonable.

This opinion also addressed two issues regarding interest.

First, how is interest computed (simple or compound) if the merger agreement is silent? The Chancery Court concluded that when parties are silent, they manifest an intent to leave that determination to the court. The Chancery Court decided that prejudgment interest should be compounded because compounding more accurately reflects the standard form of interest in the financial market.

Second, ETE argued that prejudgment interest should be tolled because there was a delay caused by an inadvertent error by Williams's discovery vendor. Then, because of that delay, the trial was further delayed by the COVID-19 pandemic. Although the Chancery Court has discretion to reduce prejudgment interest, the Chancery Court declined to toll the interest. The discovery error was inadvertent, and Williams didn't cause the pandemic. Additionally, the purpose of interest is to address the lost time value of money, and here ETE had the use of the $410 million judgment during the litigation.

If your purchase agreement has a fee-shifting clause and the other side hires counsel on a contingency fee basis, your client could be liable for the other side's contingency fee (absent a contrary provision) under Delaware law. Thus, if your client has potential liability for a contingency fee (*e.g.,* a buyer agreeing to a reverse termination fee or a seller agreeing to an indemnity—in each case, with a fee-shifting clause), you might want an express provision to the contrary. One approach is to provide that the contingency fee will be reduced to the fee payable had the prevailing party hired counsel on an hourly basis:

> …*provided, however,* that if costs and expenses include a fee determined on a contingency or similar basis, then the contingency or similar fee shall be reduced to a reasonable fee computed on the basis of an hourly rate or similar basis.

No one likes to lose in litigation. Adding insult to injury, losers that are subject to a fee-shifting provision have to pay the prevailing party's attorneys' fees. Don't make it worse by allowing that fee to be a percentage of recovery due to a contingency fee arrangement. And while you are at it, consider specifying how interest will be calculated.

SUPREME COURT (NON)DECISION IN *IN RE GRAND JURY* PRESERVES THE OPEN QUESTION OF THE SCOPE OF PRIVILEGE OVER DUAL-PURPOSE COMMUNICATIONS

By Geeta Malhotra, David Hoffman, Alexandria Daugherty, and Chris Barnes[4]

On January 23, 2023, the U.S. Supreme Court dismissed as improvidently granted, and therefore without a decision, the closely watched case, *In re Grand Jury*, which presented to the court the opportunity to clarify the scope of the attorney-client privilege in the context of dual-purpose communications. Dual-purpose communications are those that have both a business and a legal purpose. Such hybrid communications are often, though not exclusively, found in the in-house counsel context, where attorneys often wear dual hats within their respective roles. Courts have generally looked to one of two tests to determine whether a dual-purpose communication was deemed privileged—the "primary purpose" test (whether *the primary purpose* of the communication was to obtain or provide legal advice) or the "significant purpose" test (whether *one of the significant purposes* of the communication was to obtain or provide legal advice). Compounding the confusion, courts sometimes represent that they are applying a "primary purpose" test but then define "primary purpose" as "one of the significant purposes," thus effectively applying the "significant purpose" test.

Application of the two tests has created a disagreement among courts—disagreement left undisturbed now in light of the Supreme Court's decision not to hear *In re Grand Jury*. Set out below is a summary of *In re Grand Jury*, the scope and application of the two dual-purpose tests, and steps that in-house attorneys can follow to help preserve privilege and mitigate risk with respect to dual-purpose communications in the wake of the continuing uncertainty.

In re Grand Jury

In *In re Grand Jury*, an unnamed law firm that specialized in international tax issues was held in contempt for refusing to turn over tax documents in response to grand jury subpoenas on the basis of the attorney-client privilege. The law firm both provided tax advice regarding expatriation and prepared certain tax returns to certify compliance with expatriation tax requirements. The law firm claimed that the withheld documents were dual-purpose communications that should be protected as they discussed how to comply with tax laws and facilitate the preparation of the tax returns. As such, the law firm argued, among other things, that the court should apply the significant purpose test to determine the scope of privilege. The district court ruled that the tax documents were not privileged because the *primary purpose* of those communications involved tax advice, not legal advice, and the Ninth Circuit affirmed. Notably, however, the Ninth Circuit appeared to leave open the

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possibility of the significant purpose test applying in other contexts—observing the merit of the test in certain circumstances (*e.g.,* internal investigations) but noting that the test would not change the outcome in the instant case.

The Supreme Court granted the law firm's petition for writ of certiorari to address the question of "[w]hether a communication involving both legal and non-legal advice is protected by the attorney-client privilege where obtaining or providing legal advice was one of the significant purposes behind the communication." The matter was briefed, with several amicus briefs submitted in support of the law firm's position, and oral argument was held on January 9, 2023. Nevertheless, two weeks later the court dismissed the writ of certiorari as improvidently granted, thus leaving the lower court uncertainty in place and leaving unanswered the question as to how to define the scope of privilege for dual-purpose communications in light of the two different tests.

The legal profession appears to overwhelmingly favor the significant purpose test, given the broader application and more expansive protection over privileged communications. The primary purpose test has been criticized as difficult to administer and as potentially having a chilling effect on communications between companies and their counsel.

Significant Purpose Test

The significant purpose test is the broader of the two tests and was articulated by the D.C. Circuit in *Kellogg Brown & Root, Inc.,* 756 F.3d 754 (D.C. Cir. 2014). Under this test, a communication is privileged if obtaining legal advice was one of the significant purposes of the communication (or, put another way, *a* primary but not necessarily *the* primary purpose). Proponents of the significant purpose test argue that it is easier to apply than the primary purpose test because communications may have multiple purposes, and identifying a single "primary" purpose may be difficult or impossible. The significant purpose test is also endorsed by the Restatement of the Law Governing Lawyers.[5]

Primary Purpose Test

The primary purpose test, in contrast, is narrower in its application and has been adopted as the default test for attorney-client privilege by the Ninth Circuit. Under the primary purpose test, a court analyzing a mixed purpose communication must determine whether the primary purpose of a communication is to seek or provide legal advice, as opposed to business advice.[6] When making this determination, courts look to the context and content of the communication to determine if the primary purpose is legal.

Other Circuits

The two tests can be thought of as the two ends of a spectrum, with the Ninth Circuit decision (primary purpose test) on one end and the D.C. Circuit decision (significant purpose test) on the other. Other circuits fall somewhere in between, adopting some form of the primary purpose test without expressly rejecting the reasoning of the *Kellogg* decision.[7] Most circuits, including the Second, Fourth, Fifth, and Sixth, generally fall closer to the Ninth Circuit, applying the primary purpose test with some variation. For example, the Second Circuit considers whether the "predominant purpose" of the communication is to render or solicit legal advice but cautions that the predominant purpose "should be assessed dynamically and in light of the advice being sought or rendered, as well as the relationship between advice that can be rendered only by consulting the legal authorities and advice that can be given by a non-lawyer."[8] On the other end of the spectrum, a recent district court decision in the Seventh Circuit applied the significant purpose test, concluding that the Seventh Circuit had not yet addressed the issue.[9]

5 Restatement (Third) of the Law Governing Lawyers § 72 (2000), cmt. c

6 Under both the primary purpose test and the significant purpose test, a court will first attempt to sever the privileged content of the communication from the non-privileged content. If the privileged content can be severed, the document will generally be produced with the privileged content redacted.

7 See *Alomari v. Ohio Dep't of Pub. Safety,* 626 F. App'x 558, 570 (6th Cir. 2015) ("When a communication involves both legal and non-legal matters, 'we consider whether the predominant purpose of the communication is to render or solicit legal advice.'"); *In re Cnty. of Erie,* 473 F.3d 413, 420 (2d Cir. 2007) ("We consider whether the predominant purpose of the communication is to render or solicit legal advice."); *Taylor Lohmeyer Law Firm P.L.L.C. v. United States,* 957 F.3d 505, 510 (5th Cir. 2020) (explaining that the privilege applies to communications "made with the client's primary purpose having been securing either a legal opinion or legal services, or assistance in some legal proceeding"); *Bureau, Inc. v. McGraw (In re Allen),* 106 F.3d 582, 602 n.10 (4th Cir. 1997) (acknowledging that "attorney-created documents whose 'primary purpose' was 'business negotiations' rather than 'legal advice were not privileged'").

8 *In re Cnty. of Erie,* 473 F.3d 413, 420-21 (2d Cir. 2007).

9 *Smith-Brown v. Ulta Beauty, Inc.,* No. 18 C 610, 2019 WL 2644243, at *2-3 (N.D. Ill. June 27, 2019).

Currently, the legal profession appears to overwhelmingly favor the significant purpose test, given the broader application and more expansive protection over privileged communications. The primary purpose test has been criticized as difficult to administer and as potentially having a chilling effect on communications between companies and their counsel.

Practical Steps and Considerations for In-House Counsel

Regardless of the applicable test, the Supreme Court's most recent decision (or non-decision) underscores the importance of remaining sensitive to privilege considerations in the dual-purpose communications context. Of course, the easiest solution is to avoid mixing requests for legal advice with requests for non-legal input. However, that may not always be possible in light of the nature of the issue that is the subject of the communication and/or business and legal realities. And under either approach, one should expect that the court will look at context for indicators of privilege. For example, when analyzing whether an email is for the purpose of obtaining legal advice, courts may examine, among other things, whether an attorney is the sender or recipient; the number of non-lawyers on the email; the reason for inclusion of the non-lawyers; whether legal advice is explicitly requested; and whether the communication was required by company policy or by a statute or regulation.

There are several steps attorneys and clients can continue to consider to help lay the foundation for the assertion of privilege and to mitigate against the risk of losing such protection in the dual-purpose communications context.

While there is no one-size-fits-all approach to protecting privilege, there are several steps that attorneys and their clients alike can continue to consider to help lay the foundation for the assertion of privilege and to mitigate against the risk of losing such protection in the dual-purpose communications context:

- Make clear on the face of the communication that it is privileged in nature by, among other things, (1) addressing the email to the lawyer whose advice is being sought (in the "to" field), (2) copying non-lawyers in the "cc" field only when necessary, and making clear why they are being copied in relation to the privileged nature if it is not readily apparent, (3) limiting the number of recipients, and (4) emphasizing that legal advice is being sought in the subject line and body of the email.
- Instruct business teams to send legal issues directly to the legal team. If an attorney is copied on the communication, send a legal question directly to that attorney.
- Avoid emailing legal advice to email address lists that do not include names of recipients or are large distribution lists.
- Avoid forwarding documents with legal advice. If it must be forwarded, limit transmission to those who need the advice to fulfill their corporate responsibility, make clear the privileged nature of the transmission when sending, and caution recipients regarding further forwarding.
- Indicate privilege explicitly but only where applicable; avoid diluting the credibility of a privilege designation by applying it to communications that are not intended to be privileged in nature.
- When taking notes during meetings that discuss both business and legal issues, clearly designate the legal context, where possible, and limit the distribution of that portion of the notes.
- Do not assume that communications will be protected. Instead, continue to remain sensitive to the content of your communications.
- Educate business, compliance, and legal personnel as to the parameters of privilege, best practices to help maintain privilege protection, and the sensitivity regarding dual-purpose communications.

Privilege issues within business organizations remain complex, requiring careful attention by in-house lawyers and outside counsel alike. Continuing to remain sensitive to such issues, and taking steps to help lay the foundation contemporaneously, can go a long way to help mitigate risk if the communication is challenged down the line.

NEWS[10]

JUDICIAL DEVELOPMENTS

Revlon Revived: Former Executive and Private Equity Acquiror Both Held Liable for Tainted Sale Process That Failed to Maximize Stockholder Benefits

In a recent post-trial opinion in *In Re Mindbody, Inc., Stockholder Litigation,* Chancellor Kathaleen McCormick of the Delaware Chancery Court gave new life to the *Revlon* enhanced scrutiny standard of review when she held that the former CEO of Mindbody, Inc. and its private equity acquiror were liable for orchestrating and failing to fully disclose what the court found to be a sweetheart deal that deprived stockholders of the benefit of a maximized purchase price.

In 2019, a software-focused private equity firm acquired Mindbody for $1.9 billion. As early as February 2018, the CEO's external communications revealed frustration from the pressures of running a public company and a need for liquidity due to substantial financial commitments. After the CEO was introduced to the private equity firm's executives by a banker, he "quickly came to believe that selling to [that firm] gave him the unique opportunity to both gain liquidity and remain as CEO in pursuit of post-acquisition equity-based upside." The CEO notified management of the private equity firm's interest and began socializing the idea of a sale with the board, but he never disclosed his need for liquidity or strong desire for a quick sale to that firm in particular. Two weeks later, unaware of the full extent of the CEO's early discussions with the private equity firm, the board formed a transaction committee to consider running a sale process. The CEO asked a director who represented Mindbody's largest stockholder, an entity that was also interested in a near-term exit, to chair the transaction committee. Upon that chair's recommendation, the transaction committee hired the same banker who had introduced the CEO to the private equity firm. Disregarding the transaction committee's guidelines on management communications with potential bidders, the CEO tipped off the private equity firm that the company was commencing a formal sale process and the banker gave the firm a preview of the CEO's target price. The CEO also provided inside information to the private equity firm, including his plans to resign within two to three years, that was not shared with other bidders. These issues were compounded by the omission of material information about the CEO's dealings with the private equity firm from Mindbody's proxy disclosures to stockholders.

Luxor Capital Partners, L.P. and affiliates, collectively the second largest stockholder of Mindbody stock, sued both the CEO and the private equity acquiror for fiduciary duty breaches arising from the sale process that furthered the CEO's personal interests at the expense of stockholders and the failure to disclose material information about the sale process in Mindbody's proxy statement.

The court first addressed Luxor's claim that the CEO breached his fiduciary duties by tilting the sale process in favor of the private equity firm that he preferred. The court determined that Luxor's claim fit within the *Revlon* framework because the CEO had a disabling conflict from his personal desire to gain liquidity from a fast sale and expectation of post-merger

10 The following Sidley lawyers contributed to the research and writing of the pieces in this section: Elizabeth Y. Austin, Fiona Collins, Ashley J. DePalma, Sudeep S. Dhanoa, Jim Ducayet, Jarrett H. Gross, Claire Holland, Lisa Holzman, Dustin B. Page, Heather Benzmiller Sultanian, and Nilofer Umar. 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.

employment and equity-based incentives. Infected by the conflict, the court found that the CEO tilted the sale process by intentionally depressing Mindbody's stock price to make a deal more attractive to the private equity firm and giving that firm informational and timing advantages during the due diligence and go-shop periods. The court also concluded that *Corwin* cleansing was unavailable because the material omissions in the merger proxy materials meant the stockholder vote was not fully informed.

Second, the court addressed Luxor's claim that the CEO, aided and abetted by the private equity acquiror, committed disclosure violations by omitting key facts regarding the sale process in the proxy materials sent to stockholders. The court found that, taken together, the partial and complete omissions from the proxy disclosures, including sterilized descriptions of the scope of interactions between the CEO and the private equity firm, altered the total mix of information available to Mindbody stockholders such that the CEO breached his duty of disclosure. The court further found that the private equity firm had aided and abetted the CEO's disclosure-based breach because it knew that the pre-sale discussions with the CEO had not been disclosed in the merger proxy materials and failed to correct the material omissions, despite contractual obligations in the merger agreement to do so.

The Mindbody *decision serves as a reminder that conflicts that have the potential to infect a sale process must be fully disclosed and carefully managed from the perspective of both the buyer and the seller.*

The Mindbody decision serves as a reminder that conflicts that have the potential to infect a sale process must be fully disclosed and carefully managed from the perspective of both the buyer and the seller. On the seller's side, directors and executive officers must fully disclose their conflicts—to the board *and* to stockholders—to ensure that any sale process is transparent and fair, and results in a deal that maximizes stockholder value. As the court noted, "[d]irectors can manage conflicts if they are aware of them," but the board is crippled in its ability to manage conflicts if it does not even know they exist. For private equity buyers, *Mindbody* cautions that initial engagement with founders or executives who express a strong interest in doing a deal should be undertaken carefully, to ensure that both the sale process and the final deal serve the interests of the stockholders in the target company as well as the executive presenting the deal.

Delaware Chancery Court Clarifies Oversight Duties in Pair of Recent Opinions

The Delaware Chancery Court recently issued two notable opinions in *In re McDonald's Corp. Stockholder Derivative Litig.,* C.A. No. 2021-0324-JTL, which provide guidance for navigating stockholder claims alleging insufficient director and officer oversight.

In the first opinion, on January 26, 2023, the court denied a motion to dismiss duty of oversight claims brought against the company's former Global Chief People Officer and clarified that, as with directors, corporate officers' fiduciary duties encompass a duty of oversight. In the second opinion, on March 1, 2023, the court dismissed duty of oversight claims against the director defendants and provided helpful guidance on "mission critical" risks, the "gross negligence" standard under the business judgment rule, and redactions in productions of books and records under Delaware General Corporation Law (DGCL) Section 220, including the potential that a motion to dismiss relying on overly redacted documents from a 220 production could be converted to a motion for summary judgment by the court.

Following the dismissal of the claims against the director defendants, the court entered an order on March 1, 2023 granting the defendants' Rule 23.1 motion and dismissing the action in its entirety, including the claims against the company's former Global Chief People Officer, due to the plaintiff's failure to make a demand on the board.

Corporate Officers' Fiduciary Duties Entail a Duty of Oversight. The January 26, 2023 opinion clarified that the duty of oversight applies to officers. Accordingly, officers of Delaware corporations, like directors, must (1) make a good-faith effort to put in place reasonable information systems to generate the information necessary to address risks and report upward to higher-level officers or the board and (2) not consciously ignore red flags indicating that the company may suffer harm. Officers will not be held liable for violations of the duty of oversight unless they are shown to have acted in bad faith.

Unlike the duties of directors, the scope of an officer's duty of oversight may be limited to the context in which the officer operates. For example, although a CEO or chief compliance officer has a "company-wide oversight portfolio," a chief legal officer may be responsible only for oversight of risks within the legal function. The court noted, however, that where red flags are "sufficiently prominent," any officer has a duty to report upward to the CEO or the board.

Corporate officers are well advised to continue to ensure that they are receiving periodic information and conducting regular reviews of risks in their areas of responsibility and that CEOs and chief compliance officers in particular are receiving such reporting on an enterprise-wide basis. Memorialization of such risk reviews may also help in establishing that officers have endeavored to fulfill their oversight duties in good faith.

In McDonald's, *the Delaware Chancery Court clarified that director and officer oversight responsibilities extend beyond "mission critical" risks to all "central compliance risks," and if a red flag related to a risk other than a central compliance risk arises, directors and officers still have a duty to respond to it.*

Oversight Duties Extend Beyond Responding to "Mission Critical" Risks. Recent cases have highlighted that in the second type of oversight claim (a claim for conscious disregard of red flags), the court is particularly focused on red flags concerning "mission critical" risks, such as food safety for a food production company. In the March 1, 2023 *McDonald's* opinion, the court clarified, however, that a plaintiff need not establish that a red flag is related to a mission critical risk to state a red flag director oversight claim. Rather, director and officer oversight responsibilities extend beyond "mission critical" risks to all "central compliance risks," and if a red flag related to a risk other than a central compliance risk arises, directors and officers still have a duty to respond to it. Practically, however, it will be easier for a plaintiff to allege that a director's or officer's failure to respond was in bad faith for a red flags claim if the red flags concern a central compliance risk or mission critical risk.

Importantly, the court also noted that it may draw a pleadings stage inference that the risk to a company from sexual harassment or misconduct is "mission critical." In such situations, oversight claims may not be dismissed unless the board or officers can demonstrate that they took action and did not consciously disregard the red flags.

Gross Negligence Under the Business Judgment Rule Is a Higher Standard Than Criminal Negligence. The court also explained in the March 1, 2023 opinion that liability for a breach of fiduciary duty requires a director or officer to have acted, at a minimum, with gross negligence. The court explained that "gross negligence" in this context is a misnomer because "in the corporate context, gross negligence has its own special meaning that is akin to recklessness." In fact, under Delaware law, "[t]o hold a director liable for gross negligence requires conduct more serious than what is necessary to secure a conviction for criminal negligence."

Non-Responsiveness Redactions in Books and Records Productions Can Complicate Incorporation by Reference. Delaware corporations routinely redact books and records produced to stockholders pursuant to DGCL Section 220 for non-responsiveness and privilege. It is also routine for confidentiality agreements accompanying 220 productions to include—and Delaware courts have upheld—an incorporation by reference condition, pursuant to which books and records produced to the stockholder will be incorporated into any follow-on derivative complaint filed by the stockholder. The *McDonald's* plaintiff had agreed to such an incorporation by reference provision in connection with the books and records production preceding the filing of that action.

The court in the March 1, 2023 opinion discussed the possibility of converting the defendants' motion to dismiss to a motion for summary judgment, which could have been significantly more costly to defend, noting that "extensive use of the redaction tool makes a Rule 56 conversion more attractive."[11] Ultimately, the court granted the motion to dismiss

11 The court clarified that it was referring to redactions for non-responsiveness, not redactions for privilege.

and did not convert it to a motion for summary judgment, including because the unredacted portions of the books and records produced did not allow for a reasonable inference that the McDonald's board had failed to act in response to red flags. In light of this opinion, corporate defendants should continue to consider whether redactions to books and records may complicate the defendants' ability to rely on those documents on a motion to dismiss any subsequently-filed derivative lawsuit.

Procedure Prevails When Applying *MFW* Framework to Interested Merger

The Delaware Chancery Court recently issued an opinion that reminds controlling stockholders that they can successfully implement a going private merger even when a competing bidder makes an offer that is substantially higher than that offered by the controlling stockholder. The court dismissed a lawsuit brought by former Eidos Therapeutics, Inc. stockholders against BridgeBio Pharma, Inc. and three of its directors over a merger in which BridgeBio, as Eidos's controlling stockholder, acquired the remaining minority shares of Eidos stock. *Smart Loc. Unions & Councils Pension Fund v. BridgeBio Pharma, Inc.* (Del. Ch. Dec. 29, 2022).

Prior to the contested merger, Eidos was a publicly traded development-stage biopharmaceutical company focused on developing a single medication. BridgeBio owned a majority of Eidos stock and was a publicly traded company focused on developing and commercializing treatments for genetic diseases, with each drug development program housed in a separate subsidiary. When BridgeBio first expressed interest in acquiring the outstanding shares of Eidos stock in the summer of 2019, it conditioned the transaction on both the approval of a special committee of independent directors and a majority of the outstanding shares of the company not held by BridgeBio. A special committee was formed and promptly retained independent financial, legal, and industry advisers. The special committee subsequently rejected an offer by BridgeBio, and negotiations came to an end without a merger agreement in place.

In 2020, a large third-party international pharmaceutical company proposed a licensing and collaboration agreement with Eidos. The Eidos board of directors rejected this offer, and BridgeBio subsequently disclosed renewed interest in a merger. The transaction was again conditioned on approval by a special committee and a majority of the minority stockholders, and another special committee was formed and retained advisers. The third-party competitor offered to buy all of Eidos's outstanding equity, including BridgeBio's stake, at a substantial premium to the terms of the proposed BridgeBio merger agreement and later offered a substantial premium to acquire the minority shares if BridgeBio was willing to provide certain governance rights. After extended negotiations among BridgeBio, the special committee, and the third-party competitor, BridgeBio made clear that it would not grant governance rights, sell its shares in Eidos, or increase the consideration it was offering to Eidos under the merger agreement. Ultimately, the special committee approved the proposed BridgeBio transaction at a lower price than the third-party proposal, and in January 2021, the majority of Eidos's minority stockholders voted to approve the merger with BridgeBio. Suit was filed contesting the transaction.

The plaintiff's case hinged on the standard applied by the court to review the merger. The parties did not dispute that the merger was an interested transaction, and that such transactions are presumptively subject to the entire fairness standard, which requires the controlling stockholder to prove the transaction was the product of fair dealing and resulted in a fair price. Controlling stockholders can avoid this, however, if they comply with a set of six procedural requirements laid out by the Delaware Supreme Court in *Kahn v. M&F Worldwide Corp.*, 88 A.3d 635 (Del. 2014) *(MFW)*. If the requirements are met, the court will apply the business judgment rule rather than the entire fairness standard. These requirements are that (1) the controller conditioned the transaction on approval by both a special committee and a majority of the minority stockholders, (2) the special committee was independent, (3) the special committee was empowered to freely select its own advisors and to reject the transaction, (4) the special committee met its duty of care in negotiating a fair price, (5) the vote of the minority was informed, and (6) there was no coercion of the minority. The court in *SMART Local Unions* ultimately found that BridgeBio satisfied its *MFW* procedural responsibilities as the controlling stockholder and concluded that the transaction was entitled to review under the business judgment rule rather than the entire fairness standard. The court accordingly dismissed the lawsuit in its entirety.

The court began its analysis by rejecting the plaintiff's initial policy argument that the *MFW* framework should never apply to transactions where a competing bidder makes an offer that is substantially higher than that offered by the controlling stockholder and the controller refuses to sell control. The court reiterated that Delaware law does not require a controlling stockholder to accept a sale to a third party or give up its control and that such a refusal does not preclude business judgment review under the *MFW* framework.

SMART Local Unions illustrates the emphasis on procedure when a controlling stockholder negotiates a merger in which it will acquire all of the outstanding shares of a company, even where a competitor offers minority stockholders a substantial premium.

The court then walked through each of the six *MFW* factors and found that the first two *MWF* requirements were satisfied by BridgeBio's conditioning of any transaction on the approval of a committee and majority of the minority stockholders from the outset of negotiations. The court then found that the third requirement, special committee empowerment, was satisfied because the special committee rejected three proposals from BridgeBio before making a counterproposal. Thus, the plaintiff's assertion that the committee was not empowered because it ultimately approved the merger was focused on the quality of the special committee's decision making rather than its degree of empowerment.

The court found that the fourth requirement, duty of care, was satisfied because it was undisputed that the special committee retained independent financial, legal, and industry advisors. The special committee met 24 times over the course of four months. Additionally, the special committee negotiated with BridgeBio, explored the third-party competitor's alternative proposal to acquire publicly held Eidos shares, and arranged for BridgeBio and the third-party competitor to meet and discuss potential terms. Given these facts, the plaintiff did not have a basis to claim that the special committee acted with the gross negligence or recklessness needed to run afoul of *MFW*'s requirements, and the fact that a competitor's acquisition proposals reflected a substantial premium over the merger price did not by itself establish a lack of due care.

The court found that the fifth requirement was met because the vote of the minority stockholders was adequately informed. Finally, the court found that there was no coercion of minority votes. The court rejected the plaintiff's situational coercion theory, noting that Eidos was a company nearing the end of the development process for a potentially profitable pharmaceutical product and as such had acceptable alternatives to a deal with BridgeBio.

The decision is a full-throated reaffirmation of the importance of procedure when a controlling stockholder negotiates a merger in which it will acquire all the outstanding shares of a company. The Delaware Supreme Court has previously observed that procedure is central to the practical goal of the *MFW* regime, which is to use business judgment review as an incentive for controlling stockholders to embrace the procedural approach most favorable to minority investors when engaging in transactions where the controller is on both sides. *Flood v. Synutra Int'l, Inc.*, 195 A.3d 754, 756 (Del. 2018). *SMART Local Unions* is an illustration of this emphasis on procedure, even where a competitor offers minority stockholders a substantial premium.

Delaware Chancery Court Validates Putative Shares Issued in and After De-SPAC Mergers

On February 21, 2023, Vice Chancellor Lori Will of the Delaware Chancery Court issued an opinion in the *In re Lordstown Motors Corp.* case explaining the court's grant of Lordstown Motor Corporation's petition under DGCL Section 205 validating an amendment to the Lordstown certificate of incorporation that increased the corporation's authorized share count as well as the shares issued pursuant to that amended certificate of incorporation. In six sequential hearings the day before the opinion was issued, the court granted from the bench the Lordstown petition and petitions filed by five other companies that had merged with SPACs using a transaction structure for so-called "de-SPAC mergers" (through which the SPAC acquires a target) that has been widely used over the past few years.

These cases—and nearly 30 others filed in early 2023—stem from that transaction structure under which the holders of the SPAC's "Class A common stock" and "Class B common stock" voted as a single class to approve an amendment to the SPAC's certificate of incorporation, eliminating the Class B shares and increasing the SPAC's authorized share count, in connection with a de-SPAC merger. New shares of common stock (in excess of the number of shares authorized before the amendment to the certificate of incorporation) were then issued as consideration for the merger, in consideration for a third-party PIPE that directly preceded the merger, or both. Participants in many of these transactions did not believe that a separate class vote of the Class A shares was required to increase the authorized share count because the Class A and Class B shares were series of a single class of common stock rather than separate classes of stock.

Any company that has merged with a SPAC should consider whether new shares authorized in connection with the de-SPAC merger were approved with a separate class vote of each class of stock and, if not, should consider whether filing a Section 205 petition to eliminate any uncertainty as to the validity of its capital stock would be appropriate.

On December 27, 2022, the Chancery Court issued an opinion in *Garfield v. Boxed,* which held in the context of a corporate benefit analysis that Class A and Class B common stock under a similarly structured SPAC certificate of incorporation are two classes of stock rather than two series of the same class. As a result, a class vote would have been required to increase the number of authorized shares of Class A common stock, calling into question whether the shares issued in similarly structured transactions are authorized if no separate class vote was held.

Following the *Boxed* opinion, over 30 Delaware corporations have filed similar petitions under Section 205 seeking the validation of the authorized share counts in their certificates of incorporation and of the shares issued pursuant thereto. The Chancery Court has acted promptly in these cases, granting motions to expedite and setting the cases for merits hearings on each of the next several Mondays.

In the *Lordstown* opinion, recognizing the uncertainty following the *Boxed* decision, the court held that uncertainty is sufficient to invoke the court's power to validate defective corporate acts under Section 205, and the court did not address the question of whether the authorized share counts at issue actually were the result of a failure of authorization. Without analyzing whether the petitioners' shares actually were authorized and properly issued, the court held that the factors set forth in Section 205(d) favored granting the petition and validating the shares.

The court noted that as is likely the case for most companies affected by this issue, the *Lordstown* board and management had adopted the amended certificate of incorporation based on the good-faith belief that it was validly approved. They had treated it as valid and acted in reliance on it by issuing shares and disclosing the shares as issued. The court also recognized that without the relief sought in the petition, financing plans, employee relationships, commercial agreements, and prior stockholder votes and disclosures to the market could all be called into question. Moreover, the court found that no party would be harmed by the relief requested.

Any company that has merged with a SPAC should consider whether new shares authorized in connection with the de-SPAC merger were approved with a separate class vote of each class of stock and, if not, should consider whether filing a Section 205 petition to eliminate any uncertainty as to the validity of its capital stock would be appropriate.

CORPORATE GOVERNANCE DEVELOPMENTS

BlackRock Chairman Releases Annual Letter to Investors Highlighting Evolving Investment Risks and Opportunities

On March 16, 2023, Larry Fink, BlackRock's founder, chairman, and CEO, released his annual letter to investors. In past years he published two separate letters—one to CEOs and another to BlackRock's shareholders – but he wrote only one letter for 2023 recognizing that BlackRock stakeholders face common issues.

Fink outlined BlackRock's commitment and approach to aiming to deliver the best risk-adjusted financial returns for clients, consistent with their particular investment objectives and guidelines and in the face of evolving global challenges and opportunities. Fink expects high inflation to persist—he estimates 3.5% to 4% over the next few years—so long as leaders in public and private sectors continue to trade off efficiency and lower costs for resilience and national security.

BlackRock's founder, chairman, and CEO, Larry Fink: "…[A]s I have said consistently over many years now, it is for governments to make policy and enact legislation, and not for companies, including asset managers, to be the environmental police."

Noting that more than half of the money BlackRock manages relates to retirement, Fink explained that BlackRock seeks to help people navigate uncertainty, gain confidence and trust in financial institutions, and make investing more accessible, affordable, and transparent.

Because BlackRock views climate risk as an investment risk, it provides insights and data to clients regarding how climate change and the transition to a lower-carbon economy may affect their portfolios over the long term. After pushing for more disclosures about how companies plan to navigate the transition, Fink noted that more than half of S&P 500 companies now voluntarily report Scope 1 and Scope 2 emissions and he expects that percentage to increase. Nevertheless, Fink made clear that "[a]s minority shareholders, it's not our place to be telling companies what to do" and "… as I have said consistently over many years now, it is for governments to make policy and enact legislation, and not for companies, including asset managers, to be the environmental police."

Despite current challenges, Fink remains optimistic about future investment opportunities and announced BlackRock's ambition to be the leading investor in the transition finance space in the years ahead.

In the face of evolving risks and opportunities, Fink explained that BlackRock's approach is providing its clients with choice. He noted that clients representing more than $500 billion in assets under management have opted to participate in its Voting Choice platform, which allows eligible institutional investors to participate in voting decisions. With this development, robust proxy disclosures and company outreach take on greater importance.

While Fink believes voting choice has the potential to strengthen corporate governance and shareholder democracy, he said that it will work only if people invest the time and resources to make informed voting decisions. And while reliance on proxy advisors can be helpful, Fink "certainly believe[s] that the industry would benefit from more proxy advisors who can add diversity of views on shareholder issues."

Fink concluded by sharing his optimism for the future as BlackRock commits to evolve ahead of the needs of its clients and improve the ease and affordability of investing.

REGULATORY DEVELOPMENTS

Regulators Sharpen Focus on the Misuse of Rule 10b5-1 Trading Plans

The SEC has taken a renewed interest in insider trading, particularly the misuse of Rule 10b5-1 trading plans, which generally provide executives with an affirmative defense to insider trading charges if adopted in good faith and without possession of material nonpublic information. The SEC's increased scrutiny is evident in recent enforcement actions and in the now-effective amendments to Rule 10b5-1 under the Securities Exchange Act of 1934.

Earlier this month the SEC announced insider trading charges against Terren S. Peizer, the founder, chief executive officer, and chairman of Ontrak Inc., a healthcare treatment provider. The SEC's complaint alleges that Peizer avoided more than $12.7 million in losses when he sold company stock in May 2021 and August 2021 based on material nonpublic information related to Ontrak's deteriorating relationship with its largest customer, which generated more than half of the company's revenue.

In light of the recent SEC enforcement action, DOJ indictment and Rule 10b5-1 amendments, when adopting Rule 10b5-1 trading plans, issuers and insiders should take care to ensure strict compliance with the amended requirements, with particular emphasis on verifying the lack of possession of material nonpublic information.

In May 2021, Peizer established a Rule 10b5-1 trading plan. However, despite his attestation at the time that he was unaware of any material nonpublic information, the SEC alleges that Peizer knew of the strained customer relationship when establishing the plan. Peizer proceeded to execute the trading plan and sold 600,000 shares of Ontrak stock worth about $19.2 million. The SEC further alleges that months later in August 2021, after learning that the customer in question intended to formally terminate its relationship with Ontrak, Peizer adopted a second Rule 10b5-1 trading plan under which he sold 45,000 more shares of Ontrak stock worth more than $1.9 million. Shortly after this second sale, on August 19, 2021, Ontrak announced that the customer had terminated its contract with Ontrak, resulting in a 44% decline in Ontrak's stock price. The SEC's complaint claims that Peizer avoided more than $12.7 million in losses by improperly selling company stock while in possession of material nonpublic information and that he cannot avail himself of the affirmative defense under Rule 10b5-1. The SEC seeks injunctive relief, disgorgement of profits, civil penalties, and an officer and director bar for Peizer.

Beyond the SEC's civil enforcement action, the U.S. Department of Justice (DOJ) announced criminal charges against Peizer on March 1, 2023, alleging one count of engaging in a securities fraud scheme and two counts of securities fraud for insider trading. Significantly, the DOJ charges represent the first time the DOJ has ever pursued criminal charges based solely on an executive's misuse of a Rule 10b5-1 trading plan. In the DOJ's press release, Assistant Attorney General Kenneth A. Polite, Jr. underscores the increased focus on insider trading: "Today's groundbreaking insider trading indictment demonstrates that the Department of Justice, together with our law enforcement partners, will not allow corrupt executives to misuse 10b5-1 plans as a shield for insider trading."

The SEC enforcement action and DOJ criminal charges against Peizer come on the heels of the SEC's recent adoption of significant amendments to Rule 10b5-1, which took effect on February 27, 2023. Most notably, the amendments impose additional conditions to the availability of the affirmative defense to insider trading liability under Rule 10b5-1(c)(1). The new conditions include a required cooling-off period following the adoption of a Rule 10b5-1 trading plan before an insider may trade under the plan, with the length of the cooling-off period dependent on whether the insider is a director or officer or not. Further, the new conditions require directors and officers to include representations in any Rule 10b5-1 trading plan expressly stating that the insider is not aware of any material nonpublic information and is adopting the plan in good faith. The amendments also extend compliance with the good-faith requirement through the duration of the plan rather than only upon entering into the plan. Finally, the amendments limit an insider to one use of the affirmative defense in any 12-month period and prohibit insiders from having multiple overlapping Rule 10b5-1 trading plans for open market transactions, with limited exceptions.

The SEC's amendments to Rule 10b5-1 also enhance insider trading disclosure requirements for issuers and Section 16 filers. For issuers, the amendments will require quarterly disclosure of Rule 10b5-1 trading plans and other written trading arrangements, annual disclosure of insider trading policies and procedures, and certain tabular and narrative disclosures of the grant of options to named executive officers. For Section 16 filers, a checkbox was added to Forms 4 and 5 to indicate whether the transaction is intended to satisfy the Rule 10b5-1 affirmative defense requirements. Section 16 filers are also now required to disclose the disposition of shares by way of a bona fide gift within two business days of the transaction on Form 4 rather than annually on Form 5. More detailed information regarding the amendments can be found in the Sidley Update available here.

In light of the recent SEC enforcement action, DOJ indictment, and Rule 10b5-1 amendments, when adopting Rule 10b5-1 trading plans, issuers and insiders should take care to ensure strict compliance with the amended requirements, with particular emphasis on verifying the lack of possession of material nonpublic information.

Recent Enforcement Action Shows That Disclosure Controls and Whistleblower Protections Remain High SEC Priorities

On February 3, 2023, the SEC settled an enforcement action against Activision Blizzard, Inc. (Activision), a publicly traded video game development and publishing company with over 9,500 employees worldwide. The SEC charged Activision with (1) failing to maintain disclosure controls and procedures to ensure the company could assess whether its disclosures pertaining to its workforce were adequate and (2) violating the Dodd-Frank Act whistleblower protection rules by having former employees sign separation agreements requiring them to notify the company of disclosure obligations or requests from government agencies. Activision agreed to pay a $35 million penalty to settle the charges.

The Activision enforcement action is notable because it shows the SEC's willingness to charge violations of the disclosure controls and procedures provision in Rule 13a-15(a) without claiming that an issuer's disclosures were materially misleading. Such an expansive reading of Rule 13a-15(a) could have a meaningful impact on issuers.

In its Form 10-K and 10-Q filings submitted between 2018 and 2021, Activision disclosed in its risk factors that "attracting, retaining, and motivating a workforce of employees with specialized skills" could affect its business. Exchange Act Rule 13a-15(a) requires issuers to have "disclosure controls and procedures," meaning "controls and procedures designed to ensure that information required to be disclosed by an issuer in [SEC filings] is accumulated and communicated to the issuer's management … as appropriate to allow timely decisions regarding required disclosure."

According to the SEC's findings, which the company neither admitted nor denied, Activision violated Rule 13a-15(e) because it "lacked controls and procedures designed to ensure that information related to employee complaints of workplace misconduct would be communicated to Activision Blizzard's disclosure personnel to allow for timely assessment on its disclosures." The order posits that information about employee complaints and workplace misconduct is "relevant" to the company's ability to attract and retain a skilled workforce. Therefore, without information about employee complaints and workplace misconduct, Activision's management and disclosure personnel were unable to assess the accuracy of its statements about employee retention. Notably, the SEC did not find that Activision's disclosures were materially misleading.

The SEC also found that Activision's separation agreements violated Exchange Act Rule 21F-17(a) which prohibits any person from taking action to impede communications with the SEC about possible securities law violations. From 2016 through 2021, Activision, in the ordinary course of its business, had a "significant number" of its departing employees sign template separation agreements that included a clause requiring those former employees to notify Activision of any requests from administrative agencies in connection with a report or complaint. Most of the separation agreements also contained a clause clarifying that nothing in the agreement prevented the former employee from communicating with the SEC. The SEC made no finding of any instance in which a departing employee was prevented from communicating with the SEC. Nonetheless, the SEC found that the separation agreements "undermine[d] the purpose" of whistleblower protections and thus violated Rule 21F-17(a).

Given the uncertainty as to the boundaries of the SEC's broad interpretation of Rule 13a-15(a), companies should consider reviewing their disclosure controls and procedures to assess potential adjustments or enhancements to internal data tracking that bear on their current disclosures. Furthermore, companies should evaluate their employment policies, procedures, and agreements with an eye toward anything that could be viewed as interfering with whistleblower protections, including any notice requirements. Finally, companies should consider whether clarifications, emphasis, or further notice to employees on the availability of whistleblower protections may be warranted. See the Sidley Update available here for more details.

SIDLEY RESOURCES

Antitrust/Competition

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

March Antitrust Bulletin (Mar. 17, 2023). Among other things, this bulletin covers new price gouging rules proposed by the New York Attorney General that would implement legislation from 2020 and outlines significant changes the DOJ has made to its corporate criminal enforcement program.

February Antitrust Bulletin (Feb. 28, 2023). In February, we saw a number of changes in the U.S. as Commissioner Christine Wilson announced her intention to resign from her position at the Federal Trade Commission (FTC); the DOJ Antitrust Division reemphasized its focus on private equity firms; and the DOJ withdrew its antitrust healthcare guidelines, creating some uncertainty—particularly regarding information exchanges in the healthcare space and beyond. The DOJ also filed a significant case against Google, alleging monopolization of web display advertising, continuing the global trend into actions and investigations in this space.

January Antitrust Bulletin (Jan. 31, 2023). The new year started with Tim Wu stepping down from his position as an antitrust adviser to the Biden White House and the FTC proposing a rule change prohibiting non-compete clauses with workers, including independent contractors.

December Antitrust Bulletin (Dec. 22, 2022). In addition to discussing a renewed focus on a principles-based approach to European Union competition policy, this bulletin provides an overview of U.S. antitrust enforcement in 2022.

FTC Releases 2023 Thresholds for Hart-Scott-Rodino Filings and Interlocking Directorates, Raises Maximum Daily HSR Penalty (Jan. 26, 2023). The FTC approved new premerger notification thresholds under the Hart-Scott-Rodino (HSR) Antitrust Improvements Act of 1976. The statute requires the FTC to revise the thresholds annually based on changes in gross national product for transactions that close on or after February 27, 2023. The minimum "size-of-transaction" threshold for an acquisition of voting securities, noncorporate interests, or assets not exempt from HSR notification requirements increased from $101 million to $111.4 million. The FTC also announced increased thresholds, effective as of January 20, 2023, for interlocking directorates under Section 8 of the Clayton Act. Finally, the FTC announced that the maximum civil penalty amount for HSR violations increased from $46,517 per day to $50,120 per day for any civil penalties assessed on or after January 11, 2023, even where the underlying violation preceded that date.

U.S. FTC Rulemaking to Prohibit Worker Noncompetes: What Comes Next? (Jan. 10, 2023). The FTC proposed a broad ban on noncompete agreements that relies on an aggressive interpretation of the FTC's powers. The comment period and expected litigation will test whether the FTC may issue antitrust rules specifying "unfair methods of competition."

Congress Raises Filing Fees for Large Deals, Adds Foreign Subsidy Disclosure Requirement and Enables States to Retain Home Venue (Jan. 4, 2023). The Consolidated Appropriations Act, 2023, passed by Congress and signed into law by President Joe Biden on December 29, 2022, includes significant changes in merger control and state enforcement of the antitrust laws. First, the Act changes the fee structure for transactions that must be notified under the HSR Act, which is expected to generate additional revenue to fund enhanced FTC and DOJ antitrust enforcement. Second, the Act adds disclosure requirements to HSR notification filings for companies receiving subsidies from certain foreign entities to be submitted with premerger filings. Third, the Act strengthens the ability of state antitrust enforcers to retain cases at their home venue by restricting the removal of antitrust cases brought by state Attorneys General. The Act also increases the antitrust enforcement budget for fiscal year 2023, with an additional $48 million for the FTC and an additional $35 million for the Antitrust Division of the DOJ.

Banking and Financial Services

Federal Banking Regulators Announce Full Deposit Insurance Coverage of Silicon Valley Bank and Signature Bank Deposits; New Federal Reserve Bank Lending Program (Mar. 12, 2023). On March 12, 2023, the Department of the Treasury, Board of Governors of the Federal Reserve System, and the Federal Deposit Insurance Corporation (FDIC) announced that all depositors of Silicon Valley Bank and Signature Bank, the latter of which was placed into FDIC receivership that evening, would have access to the full amount of their deposits—insured and uninsured—beginning March 13. At the same time, the Board of Governors of the Federal Reserve System also announced the implementation of a new term funding program for eligible depository institutions and U.S. branches and agencies of foreign banks, meant to address liquidity issues arising from mismatches between long-term asset maturities and near-term depositor demand.

Corporate Governance and SEC Disclosure

Preparing Your 2022 Form 10-K: A Summary of Recent Key Disclosure Developments, Priorities, and Trends (Jan. 13, 2023). This Sidley Update highlights certain key disclosure considerations for preparing your annual report on Form 10-K for fiscal year 2022, including recent amendments to SEC disclosure rules and other developments that impact 2022 Form 10-K filings, as well as certain significant disclosure trends and current areas of SEC focus for disclosures.

ISS and Glass Lewis Proxy Voting Policy Updates for the 2023 Proxy Season (Dec. 23, 2022). Proxy advisory firms Institutional Shareholder Services (ISS) and Glass Lewis & Co. (Glass Lewis) have updated their proxy voting policies for 2023 shareholder meetings, including key policy updates relating to board diversity and related disclosures, officer exculpation charter amendment proposals, board accountability for climate-related issues and problematic governance and capital structures, board oversight of environmental and social issues and cyber risk, director overboarding, and shareholder proposals requesting racial equity audits or disclosure about political spending and lobbying congruency.

Labor and Employment

U.S. Employers Need to Reconsider Use of Confidentiality and Nondisparagement Provisions in Light of New NLRB Decision (Mar. 3, 2023). In February, the U.S. National Labor Relations Board significantly altered the legal landscape governing confidentiality and nondisparagement provisions in severance agreements provided to departing employees, making it much more difficult for unionized and nonunionized employers alike to use them for nonsupervisory employees without running afoul of the National Labor Relations Act. The decision is likely to be appealed. In the interim, however, it is critically important for employers to understand the implications of the decision and to adjust their use of these provisions to limit their risk.

FTC Proposes Rule to Ban Non-compete Clauses Between Employers and Workers (Jan. 6, 2023). On January 5, 2023, the FTC published a proposed rule that would significantly change the federal law by prohibiting employers from imposing non-compete clauses on workers, including independent contractors. The proposed rule also requires employers to rescind existing non-compete clauses with workers and actively inform workers that any such clauses are no longer in effect. There is a limited exception in the proposed rule for non-compete clauses between the seller and buyer of a business, but then only for substantial owners, which the proposed rule defines as those who own at least 25% of the entity being sold—an exception even more narrow than California's restrictive rule. If adopted, the proposed rule would supersede any state or local law or regulation governing non-compete clauses.

M&A

What it Takes to Score in High-Stakes Sports Acquisitions (Feb. 2023). It's time to play ball, both on the field and off. As this year's pro football season culminates with the big game, the business of sports is booming. More teams are for sale, buyers are lining up, and valuations are through the roof. In this episode of *The Sidley Podcast*, Sidley partner host Sam Gandhi speaks with two of the firm's thought leaders on the sports industry—Charles Baker and Irwin Raij. They discuss the acquisition of sports teams and their media assets, the lure for investors, and emerging trends in the industry.

SPAC in Action: Court of Chancery Applies Entire Fairness Review in Declining to Dismiss SPAC Lawsuit (Feb. 21, 2023). The recent Delaware Court of Chancery decision in *Delman v. GigAcquisitions3* offers interesting insights into the circumstances in which "entire fairness" review applies and where "Corwin cleansing" can be used to achieve a lesser review standard.

Key Considerations for Cross-Border M&A in the Mining and Metals Industry (Feb. 15, 2023). In 2022, notwithstanding volatile markets, mining and metals companies explored M&A at the highest levels in years. While domestic production is incentivized and growing, the nature of the industry and the location of critical minerals has led to significant M&A activity occurring on a cross-border basis. A thoughtful, well-advised, and agile approach is required to achieve the potential rewards of deal-making in a fluid market. This article considers certain key considerations for mining and metals companies undertaking a cross-border M&A transaction, including collaboration and preparation across a range of constituencies and advisors, competition law and foreign investment controls, trade policies and incentives, government relations and compliance, ESG and community relations, tax and cash management, and public company disclosure obligations.

Tax

IRS Guidance on 1% Excise Tax Helpful for De-SPAC Transactions with Private Targets (Jan. 9, 2023). On December 27, 2022, the Internal Revenue Service and U.S. Treasury issued Notice 2023-2, which provides interim guidance addressing the 1% excise tax on stock repurchases by certain publicly traded corporations under Code Section 4501. The excise tax was enacted into law in the Inflation Reduction Act on August 12, 2022. Although the Notice does not specifically reference SPACs, commentators have widely discussed the impact of the Notice on SPAC liquidations and the ability to use private investment in public equity issuances in connection with a de-SPAC transaction to offset the excise tax base.

White Collar: Government Litigation and Investigations; Corporate Compliance

U.S. DOJ Issues New Policy on Voluntary Self-Disclosure and Environmental Crimes (Mar. 13, 2023). The Environmental Crimes Section of the DOJ has revised its Voluntary Self-Disclosure Policy for potential criminal violations of environmental laws. This policy highlights the value of a robust internal audit program, and companies investigating potential noncompliance should consider the new policy along with other voluntary disclosure policies.

U.S. DOJ Unveils New Components of Effective Corporate Compliance Programs (Mar. 3, 2023). On March 3, 2023, Assistant Attorney General Kenneth Polite delivered remarks at the American Bar Association's annual National Institute on White Collar Crime. In his speech, he unveiled updates to DOJ's Evaluation of Corporate Compliance Programs. This Sidley Update focuses on two of the most notable changes, which include (1) Polite's announcement regarding how the DOJ considers a corporation's approach to the use of personal devices as well as various communication platforms and messaging applications and (2) clarification regarding how the government will assess corporate compensation structures. Companies should review these developments and take steps to critically assess their compliance programs to help prepare for and align with the DOJ's new expectations for effective compliance programs.

U.S. DOJ Weighs in on Corporate Compensation and Clawbacks (Mar. 2, 2023). On March 2, 2023, Deputy Attorney General Lisa Monaco, in a speech at the American Bar Association's annual National Institute on White Collar Crime, announced a number of updated policies and resource allocations aimed at combatting corporate fraud, including the DOJ's recent revisions to its corporate self-disclosure programs and the announcement of two resource commitments to address instances where there is an intersection of corporate crime and national security implications. The most significant of the announcements related to a new pilot program intended to shift accountability for corporate wrongdoing from shareholders to executives and other personnel identified as responsible for the misconduct.

Implications of the U.S. DOJ's Corporate Voluntary Self-Disclosure Policy (Feb. 22, 2023). On February 22, 2023, the DOJ issued a Corporate Voluntary Self-Disclosure Policy (VSD Policy) to formalize its efforts to incentivize voluntary self-disclosure. The VSD Policy builds on the DOJ's revised Corporate Enforcement and Voluntary Self-Disclosure Policy from January 2023. The VSD Policy applies to all U.S. Attorney's Offices and is effective immediately. Along with analyzing the rationale underlying the VSD Policy, the applicable standard, and potential benefits to the companies that engage in VSD, this Sidley Update also provides key considerations when assessing whether to voluntarily self-disclose known misconduct to the DOJ.

Where Caremark Meets Park: A New Era of Regulatory Compliance and Criminal Liability (Feb. 16, 2023). In a recent post on PharmExec.com, Paul Kalb (a co-founder of Sidley's Global Life Science practice) and Coleen Klasmeier (a former partner who co-led Sidley's Food, Drug, and Medical Device practice) discuss how the intersection of the *Caremark* and *Park* doctrines impact life science companies, particularly when it comes to regulatory compliance and the liability of company officials.

Invigorating the Corporate Criminal Enforcement Program: U.S. Department of Justice Seeks to Entice Companies to Self-Report (Jan. 27, 2023). In January, the Criminal Division of the DOJ released a revised Corporate Enforcement and Voluntary Self-Disclosure Policy (CEP) that offers significant incentives for companies to self-disclose corporate misconduct, cooperate with the DOJ, and remediate. Some of the most notable changes include (1) the possibility for companies to obtain a declination even in the presence of aggravating circumstances, (2) the ability for a recidivist company to obtain cooperation credit, and (3) increased reductions on fines for companies that either self-disclosed or cooperated extensively with the investigation and fully remediated the misconduct but failed to self-disclose. In this Sidley Update, we explain the new CEP, highlight the changes from the previous version, and offer our thoughts on whether the new CEP is likely to help "invigorate" the DOJ's efforts to combat corporate crime. We also draw a line back to Deputy Attorney General Lisa Monaco's announcements last fall to provide a more comprehensive read of this new policy and outline any remaining gray areas in the DOJ's corporate enforcement guidelines.

SIDLEY EVENTS

Webinar on What In-House Counsel Should Know and Advise Their Boards About Per- and Polyfluoroalkyl Substances (PFAS), the Emerging Contaminant on Everyone's Radar

March 30 | Virtual

Please join Sidley's multidisciplinary PFAS team for a webinar on March 30, 2023 to hear an overview of PFAS and learn about related regulatory developments and risk management issues. For more information, please contact laevents@sidley.com.

Privacy and Cybersecurity Roundtable

April 3 | Washington, D.C.

Join us on April 3, 2023 in Sidley's Washington, D.C. office for our annual Roundtable featuring industry leaders and government officials to discuss governance and artificial intelligence, national cybersecurity guidance, and regulatory updates from a UK perspective. For more information, please contact dcevents@sidley.com.

Webinar on Crisis Management – Hard Conversations With the Board

April 18 | Virtual

Please join us on April 18, 2023 for a thoughtful discussion and analysis designed for board members, general counsel, and other in-house legal team members. Our panel will discuss the importance of timely and appropriate board engagement in the wake of a crisis to mitigate liability and successfully navigate the multitude of issues a crisis entails. For more information, please contact hnevents@sidley.com.

SIDLEY SPEAKERS

American Bar Association Business Law Section Hybrid Spring Meeting 2023

April 27-29 | Seattle, WA or Virtual

Sandi Knox, leader of Sidley's Corporate Venture Capital practice, will lead a panel discussion titled *Current Issues in Corporate Venture: New Deal Structures and Documentation* on April 29, 2023 at the Hybrid Spring Meeting of the Business Law Section of the American Bar Association. Click here for more information.

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