



Sidley Perspectives

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ANALYSIS

AI AND THE ROLE OF THE BOARD OF DIRECTORS

By: Holly J. Gregory¹

In 1950, Alan Turing, the father of computer science, famously asked, “Can machines think?” Since then, the application of computer science and algorithms to collect and analyze data, identify patterns, make predictions, and solve problems has advanced significantly. Today’s artificial intelligence (AI) has become much better at mimicking aspects of human intelligence, such as “understanding” language, “perceiving” images, and “generating” new, albeit derivative, content (generative AI). AI is also advancing in its ability to self-improve its own performance (machine learning).

As a transformative technology, AI has the capacity to disrupt entire industries, creating new business opportunities and presenting new risks for companies. Companies also play a key role in AI-related research and development (R&D) and deployment, with the potential for considerable societal impact. Boards of directors and their advisors need to consider:

- how AI is currently used by the company and its competitors
- how AI may disrupt the company’s business and industry
- the strategic implications and risks associated with AI products and services
- the impact of AI applications on the workforce and other stakeholders
- the implications for compliance with legal, regulatory, and ethical obligations
- the governance implications of the use of AI and related policies and controls

Board responsibility for managing and directing the company’s affairs requires oversight of the exercise of authority delegated to management, including oversight of legal compliance and ethics and enterprise risk management. The board’s oversight obligations extend to the company’s use of AI, and the same fiduciary mindset and attention to internal controls and policies are necessary. Directors must understand how AI impacts the company and its obligations, opportunities, and risks and apply the same general oversight approach as they apply to other management, compliance, risk, and disclosure topics.

Understanding AI as a Matter of Corporate Strategy and Risk

As with any emerging technology, AI presents opportunities for competitive advantage and innovation while also presenting significant potential for risks. Boards and management teams need to assess the impact of AI on corporate strategy and risk, and specifically consider:

- how AI is currently used, for example, to support innovation and R&D, enhance customer experiences, manage the supply chain, reduce risk, or otherwise improve efficiency and reduce costs
- how AI may change the industry and the business
- strategic opportunities AI presents that have not yet been captured
- associated operational, financial, compliance, and reputational risks

Boards should explore with management how to best use AI to help achieve business objectives and further opportunities to capitalize on AI. Consideration should be given to how AI is likely to disrupt the industry in the future, implications for the current business model, and any changes needed for the company to capture opportunities to use AI for competitive advantage through innovation and the creation of new business models or revenue streams.

Directors must understand how AI impacts the company and its obligations, opportunities, and risks and apply the same general oversight approach as they apply to other management, compliance, risk, and disclosure topics.

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Boards need to understand the potential for AI-related risks and the systems in place to help manage and mitigate those risks, including systems to safeguard data, and ensure both that the AI systems are secure and that the company is in compliance with AI-related rules and regulations.

In addition to providing opportunities for competitive advantage, AI has the potential to both create and manage risk. On the risk creation side, AI systems are highly dependent on data, and there is a risk of bias and other errors with the data, the algorithm, or both that could lead to error and unintended outcomes. For example, the data may be biased by the way the information is obtained or used, and the algorithms may be biased due to erroneous assumptions in the machine learning process. High data dependency also gives rise to the risk of disputes over data rights, privacy violations, and cybersecurity breaches.

There is also considerable concern about how AI is being developed and deployed and whether it will harm society. At a recent Yale summit of CEOs, 42% indicated that they were concerned about the potentially catastrophic impact of AI.² Boards need to understand the potential for AI-related risks and the systems in place to help manage and mitigate those risks, including systems to safeguard data, and ensure both that the AI systems are secure and that the company is in compliance with AI-related rules and regulations.

On the risk management side, AI applications can help identify and mitigate risks. For example, AI has proven useful in the financial services industry for detecting credit card and other financial fraud, in cybersecurity defense by further automating vulnerability management and intrusion detection, and in compliance applications to identify a variety of policy violations.

Significant work is underway to help companies address AI-related risks. In January 2023, the U.S. Department of Commerce's National Institute of Standards and Technology (NIST) issued the [Artificial Intelligence Risk Management Framework](#), which was developed with input from both the private and public sectors as a voluntary, flexible risk framework to "promote trustworthy and responsible development and use of AI systems." The framework identifies characteristics of trustworthy AI systems, such as being "valid and reliable, safe, secure and resilient, accountable and transparent, explainable and interpretable, privacy-enhanced, and fair with harmful bias managed." Notably, NIST has called on companies to establish policies that define AI risk management roles and responsibilities, including for the board.

Considering the Impact of AI Activities

AI, and in particular generative AI, raises considerable concerns about the potential for misuse and unintended consequences. Boards and management teams need to consider the responsible corporate use of AI and the potential impact on employees, customers, other key stakeholders, and the environment. Consideration should be given to avoiding and mitigating unintended consequences, including through the use of policies and internal controls overseen by the board or an appropriate board committee.

AI can provide efficiency with routine tasks and is improving in its ability to aggregate data, recognize patterns, and create content, with the prospect of freeing up employees to increase their focus on tasks that require judgment and creativity. AI's growing potential to automate skilled tasks has implications for workforce training, management, and productivity. Boards should consider how the company's use of AI is impacting employees and the talent pipeline, whether employees are being trained to use AI in a manner that leverages their skills and mitigates AI risks, and what types of policies should be implemented to encourage appropriate use of AI by employees for approved use cases—particularly in highly regulated or otherwise high-risk contexts, such as healthcare, financial services, or hiring and promotion decisions.

AI's potential for perpetuating bias in the datasets on which it relies raises concerns about the use of AI in employment and promotion decisions. The board should understand whether and, if so, how the company uses AI for these purposes and what policies are in place regarding these uses. The use of AI in employment-related decisions may be subject

² Chief Executive, At Yale CEO Event Honoring Steven Spielberg, Little Consensus on AI Future.

to regulation, and regulation in this area is likely to expand. For example, New York City Local Law 144 of 2021 prohibits employers and employment agencies from using an “automated employment decision tool” unless the tool has been subject to a bias audit within the prior year, information about the bias audit is publicly available, and certain notices have been provided to employees or job candidates (N.Y.C. Admin. Code §§ 20-870 to 20-874; 6 RCNY §§ 5-300 to 5-304 (rules implementing Local Law 144)). Enforcement of this law and related rules began on July 5, 2023.

In 2021, the Equal Employment Opportunity Commission (EEOC) announced an initiative aimed at ensuring that AI tools used in employment decisions comply with the federal civil rights laws. The initiative includes gathering information about the adoption, design, and impact of AI technologies and issuing guidance for employers on AI use and algorithmic fairness. The EEOC also issued, in May 2023, technical assistance regarding AI and algorithmic decision-making tools and the potential for those tools to result in illegal discrimination under Title VII. This guidance focuses on disparate impact in employment selection processes. Additionally, state privacy laws (such as the California Consumer Privacy Act) and the EU General Data Protection Regulation apply to employee data and can add regulatory obligations around profiling and automated decision-making.

Boards should also understand how AI is used by customers and suppliers as well as its impact on the environment. The use of AI is already well-embedded in various industries, such as the automotive, e-commerce, entertainment, financial services, healthcare, hospitality, insurance, logistics, manufacturing, marketing, retail, and transportation industries. Boards may not understand the ways in which their companies or others in their industries are using AI to interface with customers and suppliers, and the extent to which these uses involve data gathering, with privacy implications and related concerns about bias. Additionally, boards may not appreciate the environmental impact of, for example, training an algorithm to identify reliable patterns, which can require heavy energy use to analyze millions of datasets.

Overseeing AI-Related Compliance and Controls

AI raises compliance issues that require board consideration. AI systems can incorporate bias and lack transparency, which may lead to concerns about equity and accountability. Additionally, AI systems are heavily reliant on data and often implicate privacy and data protection regulation. The use of AI—and generative AI in particular—may have implications for intellectual property (IP) protections.

Not surprisingly, AI is the focus of legislative and regulatory initiatives in the U.S. and abroad. Boards need to understand and stay apprised of these developments 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 potential risks. In doing so, they should be mindful of the variety of ways in which the company may face exposure to AI-related compliance and other risks, including through AI technology that is internally developed, licensed from others, or acquired through M&A activity.

AI-related regulation seeks to balance the interest in encouraging innovation with concerns about human rights and civil liberties, including privacy rights, anti-discrimination interests, consumer safety and protection, IP protection, information integrity, security, and fair business practices.

Practice Pointers

As corporate use of AI expands, the board needs to understand the role of AI in the business and how it is integrated into decision-making processes. The board should also consider how AI can be used to support its own efforts, for example, its ability to collect and analyze data and identify trends that may improve financial projections and capital allocation

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 potential risks.

Board oversight is key to ensuring that AI is used in a responsible and ethical manner in alignment with the company's strategic objectives and values.

decisions. AI may also help anticipate and identify potential risks, inform efforts to mitigate risks, and predict outcomes. AI may be used in information and reporting systems to identify matters for board attention in a more timely manner or otherwise used to improve the information available to the board.

Board oversight is key to ensuring that AI is used in a responsible and ethical manner in alignment with the company's strategic objectives and values. This requires that board members understand how AI is used in the company and what potential opportunities and risks AI presents, including risks from algorithm and data bias. Mitigating these risks requires ensuring that the data used to train AI algorithms is diverse and representative and that the algorithms themselves are transparent and explainable.

To effectively oversee the use of AI, the board should consider establishing clear reporting lines and metrics for measuring the effectiveness of AI as well as ensuring that it receives regular updates on the company's use of AI and any associated opportunities and risks. From a practical perspective, in approaching oversight of AI, directors can rely on the same fiduciary mindset and attention to internal controls and policies as they apply to other matters.

Together with its advisors, the board should consider a variety of AI-related issues. The board should ensure it has an adequate understanding of:

- how the business and industry could be disrupted by AI and what strategic opportunities and risks AI presents
- how AI is used in company processes and third-party products used by the company
- how the company is positioned to leverage its data assets, the risks that may stem from the use of data for the AI use cases, and management's existing processes for tracking and protecting the data used to train or be fed into AI tools
- the AI governance system management has put in place, including whether the system has appropriate input from relevant business functions, IT, human resources, legal, risk, and compliance
- the company's goals and why AI is the right tool for achieving them; in evaluating this issue, the board should seek management's input on:
 - whether the company has the expertise and resources to pursue a strategy that relies on AI in a responsible way
 - how resilient the company's use of AI is in terms of cybersecurity, operations, and data access and management
 - how success will be measured
 - what proof of concept will look like, and how to test for efficacy and compliance as an AI initiative launches and as AI use develops over time
 - what the key risks are and what risk mitigation tools are available
 - whether there are material disclosure considerations relevant to any audience (such as users, regulators, business partners, or shareholders)

The board should also evaluate:

- the need for or outcome of discussions with management about the NIST AI Risk Management Framework and its application to the company
- whether it has appropriate access to information, advice, and expertise on AI matters to be able to understand strategic opportunities and risks and consider related controls
- what additional steps should be taken to ensure that the board is kept appropriately informed on AI matters
- whether management has identified:

- risks to the business from AI
- any mission-critical compliance or safety risks related to the company's use of AI and, if so, discussed them with the board (these risks should be mapped to a board committee for more frequent and in-depth attention and reflected in the committee charter, agenda, and minutes)
- whether the board (or the responsible board committee):
 - appropriately reflects AI issues on its agenda
 - is regularly updated about rapidly emerging legislative and regulatory developments related to the use of AI
 - has reviewed the company's policies and procedures concerning the use of AI
 - has considered, together with management, the implications of AI for the company's cybersecurity, privacy, and other compliance policies and controls programs
 - has discussed with management the potential for misuse and unintended consequences from the company's use of AI with respect to employees, customers, other key stakeholders, and the environment and how to avoid or mitigate those risks
 - understands the extent to which AI is used in tracking and assessing employee performance, and has ensured that controls are in place to foster compliance with any relevant regulation
 - understands who in the company is responsible for monitoring AI use, and AI-specific compliance and risk management, and how the company ensures compliance with AI-specific requirements, such as "secure by design" requirements
 - oversees the company's policies and procedures related to the use of generative AI, including whether those policies and procedures consider the potential for bias, inaccuracy, breach of privacy, and related issues of consumer protection, cyber and data security, IP protection, and quality control.

THE BOARD AS ACTIVIST

By Derek Zaba, Kai H.E. Liekefett, Holly J. Gregory, and Loren Braswell³

The universal proxy rules, which went into effect on September 1, 2022, have shifted the landscape of shareholder activism by allowing shareholders to "mix and match" their votes across proxy cards in contested elections. Since last September, the move to candidate-based (rather than slate-based) voting has encouraged activists to nominate smaller, more targeted slates, and the added leverage in settlement negotiations has ultimately resulted in activists winning a larger number of board seats. In addition, mega-cap companies in the U.S. have been targeted more than ever before, despite a modest decline in total campaigns, with some companies becoming targets of the growing "swarming" phenomenon, whereby multiple activists target a vulnerable company concurrently or in rapid succession.

In response to the heightened threat posed by these changes, boards can benefit from stepping directly into the shoes of an activist, thinking critically and objectively about the vulnerabilities of their companies in key areas, and taking proactive steps to address such vulnerabilities.

In response to the heightened threat of shareholder activism, boards can benefit from stepping directly into the shoes of an activist, thinking critically and objectively about the vulnerabilities of their companies in key areas, and taking proactive steps to address such vulnerabilities.

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The board should objectively assess its own structure and composition through the lens of an activist to ensure that they reflect the changing needs of the company as well as a diversity of genders, ethnicities, and ages.

Strategy

The best defense against shareholder activism is a clear and well-articulated strategy, and strong execution of such strategy, as evidenced by financial performance. As boards consider management's proposals and help hone strategic and operational decisions, among other things, they should consider how such actions may be viewed through an activist lens.

The board should compare the company's performance to that of its peers and relevant indices (particularly with respect to total shareholder return, or TSR, and operational metrics) and identify where the company might fall short in the eyes of an activist. When assessing strategic decisions, the board should take a critical approach and test management's underlying assumptions. Given the trend toward ESG-related activism, including activism campaigns touting ESG concerns as an add-on to their main thesis, the board should also ensure that the company genuinely incorporates ESG into its strategic initiatives and updates its public disclosures to reflect such initiatives.

Corporate Governance

Corporate governance should be a key focus of the board's analysis of the company. Activists always exploit a company's governance vulnerabilities as part of their broader activism campaigns. Therefore, it is important to regularly review the company's organizational documents to ensure that they reflect up-to-date best practices and are well-tailored to the company's specific circumstances. As an example, companies should confirm that the advance notice section of their bylaws is appropriately updated in light of the new universal proxy rules.

Activists will also target boards that are not well-refreshed and, in particular, directors whose skills, experiences, tenure, and background do not align with the activist's view of what the boardroom needs. The board should objectively assess its own structure and composition through the lens of an activist to ensure that they reflect the changing needs of the company as well as a diversity of genders, ethnicities, and ages. When vulnerabilities or gaps in the boardroom become evident, it is critical that the board make the tough decisions necessary for proper refreshment rather than defaulting to the renomination of existing directors.

Shareholder Engagement

Effective relationship building with a company's shareholders is often the greatest tool in the activist's toolbox. Therefore, the board should work with its internal investor relations team and advisors to create a robust shareholder engagement program that lays the groundwork for an open and candid relationship with shareholders in the event of a proxy contest. Research demonstrates that shareholder engagement is associated with increased shareholder confidence in management and the board as well as a lower likelihood of activism (and that when companies do experience activism, those with greater engagement have less costly campaigns).

As part of its shareholder engagement program, the company should get to know its broad base of investors, including what motivates them, what concerns them, and what excites them. The shareholder base is not monolithic—all investors do not necessarily value the same things. When engaging with investors, the company should understand and be proactive about any feedback it receives and address any misconceptions that investors may have.

In addition to shareholder engagement, the company should work toward cultivating strong relationships with other third-party constituents, such as analysts, proxy advisory firms, and the media, who can also play an important role in a future proxy contest.

While there is no panacea for the risk that shareholder activism poses to public companies, boards can put their companies in a strong position to anticipate and tackle potential activism attacks by thinking like an activist and taking proactive steps to identify and address vulnerabilities.

Contingency Planning

Even for companies not currently under an activist attack, it is beneficial to be thoughtful about contingency planning, so that the board and management team know exactly how to proceed and can respond quickly if an activist does emerge.

An effective contingency plan would include putting an early warning system in place for the arrival of an activist and retaining a team of advisors—including legal counsel, an investment bank, a PR firm, and a proxy solicitor—prepared to guide the company in the event of an activism campaign. The company should also put in place a “break the glass” response plan for the most likely contingencies, particularly in the case of an “ambush” public attack without warning from the activist, and conduct annual tabletop exercises as a board to simulate various activism scenarios. Finally, the company should consider the placement of a shareholder rights plan on the shelf in case an activist begins to rapidly accumulate a stake in the company.

By planning in advance for the potential arrival of an activist, the board can help to minimize the chance of activism and, should it occur, place the company on an even footing with the activist.

While there is no panacea for the risk that shareholder activism poses to public companies, boards can put their companies in a strong position to anticipate and tackle potential activism attacks by thinking like an activist and taking proactive steps to identify and address vulnerabilities. Ultimately, boards must apply their own business judgment in making decisions in the best interests of the company’s shareholders, but the discipline of considering the company’s actions through the perspective of an activist is a useful and instructive exercise in self-reflection.

FIVE ESSENTIAL D&O INSURANCE QUESTIONS

By John M. Skakun III⁴

Litigation has long been a fact of life for directors of U.S. public companies. The risk of personal financial liability has increased lately, though, particularly from shareholder derivative litigation alleging breaches of fiduciary duty. In a departure from the historical trend, a series of recent Delaware cases have declined to dismiss fiduciary duty claims and have raised the standards to which directors are held. This has unsurprisingly caught the attention of plaintiffs and translated into a significant increase in the value of derivative settlements. Since 2020, there have been at least 11 derivative settlements greater than \$100 million. The 10 largest derivative settlements range from \$167 million to an eye-popping \$735 million, and all but two are from the last three years. Because Delaware law prohibits companies from indemnifying monetary derivative settlements (or judgments), they must be paid either by directors and officers (D&O) insurance or by directors personally.

D&O insurance is thus more important than ever in protecting the board from personal financial exposure. D&O policies are complex, bespoke contracts that often include heavily negotiated “endorsements” that alter the underlying policy form. Directors should take an active role in ensuring that management procures effective and appropriate coverage. The following five questions can help directors understand their D&O coverage and ensure that it adequately protects them.

What are the coverage limits—and how much is Side A only? The first, and most obvious, consideration for D&O insurance is the total amount of coverage. There is no one-size-fits-all answer to how much coverage is appropriate, and factors to consider include the company’s

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market capitalization, its industry and regulatory risk profile, litigation trends, and benchmarking against peers. The board should understand the analysis and judgments that informed management's selection of coverage limits.

The board should also understand how much of the coverage is dedicated to "Side A only." There are traditionally three types, or "sides," of D&O insurance. In simplified terms, Side A covers only individual directors and officers, Side B reimburses the company after it indemnifies individual directors and officers, and Side C protects the company for its securities litigation risk. Because Side A-only coverage is reserved for the protection of individuals, it cannot be depleted by the company. A well-designed D&O program should have a meaningful amount of coverage that is Side A-only. The Side A-only coverage should also be "DIC," or "difference in conditions," meaning that it will provide first-dollar protection without a deductible when triggered.

What are the conduct exclusions for the Side A coverage? The highest limits in the world do no good if a coverage exclusion is triggered. Perhaps the most important exclusion from a director's perspective is the conduct exclusion to Side A coverage. This is one of the very few exclusions to Side A coverage, but it can be especially consequential because it applies to self-interested, fraudulent, and criminal conduct—precisely the kind of conduct likely to be alleged against directors.

The conduct exclusion can be significantly limited and even eliminated in certain circumstances. It's now common for Side A policies to provide that the conduct exclusion is triggered only if the relevant misconduct is established by a final, non-appealable judgment in an underlying lawsuit (i.e., not one brought by an insurer seeking to avoid coverage). Side A policies also often include critical carve-backs providing that the conduct exclusion does not apply to legal fees or to independent directors. This exclusion is one of the most heavily negotiated in policies, and small differences in language can have critical consequences when coverage is needed.

What is the "prior acts" date? Another key exclusion is the prior-acts bar. This common provision precludes any coverage for claims involving, even in part, conduct that occurred before a certain date (often, but not always, the date a carrier began providing D&O coverage to the company). Because shareholder claims often allege a long period of wrongdoing—allegations of oversight failures going back five to 10 years are common—a recent prior-acts date can meaningfully limit the availability of coverage.

Is there coverage for government investigations? D&O insurance generally covers a "claim" alleging a wrongful act by an insured person. This "claims-made" framework has historically created uncertainty around coverage for government investigations. This is because investigations are often framed as information-gathering operations, with the first express allegation of wrongdoing coming if and when charges are filed.

Because of the importance—and expense—of having counsel defend an investigation, D&O policies have evolved to frequently include some sort of "pre-claim inquiry" (or similarly named) coverage. The terms of such coverage can vary widely. It's important to consider the policy language in light of the particular types of regulatory investigations the company may face.

What is the company doing to lessen the board's litigation risk? Even better than having great D&O insurance is not needing the coverage. Companies can do much in addition to insurance to limit directors' personal financial exposure. The charter can exculpate monetary liability for duty of care claims. The charter and bylaws can mandate indemnification and advancement whenever it is legally permitted and designate the forum for derivative litigation. Indemnification agreements can strengthen indemnification and advancement rights and provide procedural protections to ensure they are honored even after an individual leaves the company.

Directors should take an active role in ensuring that management procures effective and appropriate D&O insurance coverage to protect them from personal financial exposure.

Fiduciary duty litigation risk can also be mitigated through strong risk management controls. Recent Delaware cases have raised the standard for director conduct but also have provided guidance on how to defeat fiduciary duty claims. Particularly important is knowing the company's mission-critical and core compliance risks, knowing the corporate officers responsible for those risks and ensuring there is a written, non-privileged record of the board getting information about those risks and making business judgments in response. Also critical is careful communication; undisciplined emails or texts are a too-frequent source of exposure for boards.

Careful vetting of D&O coverage should be a priority for boards given today's litigation environment. Preparation is the best form of prevention, and asking the right questions now, before claims are filed, can ensure adequate coverage when needed.

NEWS⁵

JUDICIAL DEVELOPMENTS

Magellan Health: A New North Star for Mootness Fee Disputes May Reduce Payments to Plaintiff's Counsel

The path to a mootness fee is well worn. A stockholder plaintiff sues alleging that a company's disclosures or other decisions were inadequate or improper. The company responds by issuing disclosures or taking actions that moot the plaintiff's claims. This, laudably, avoids the expense and distraction of litigation.

But that leaves a second-order question: how much should plaintiff's counsel be paid for the putative, non-monetary "corporate benefit" they have achieved? The prospect of such counsel fees, often predicated on negligible benefits to stockholders, has been understandably deemed a "deal tax." Recent doctrinal developments have made such litigation less desirable to pursue in the Delaware Chancery Court. Unsurprisingly, we have seen the increased repackaging of such claims as federal securities claims, which are then instead pursued in disparate federal courts across the country.

Chancellor Kathaleen St. J. McCormick's recent [decision](#) in *Anderson v. Magellan Health, Inc.* (Del. Ch. July 6, 2023) provides rare guidance for those assessing mootness fee disputes and indicates that heightened scrutiny of such requests is appropriate. As for supplemental disclosures specifically: the go-forward expectation is that a mootness fee award will be predicated on the additive information being "material," not merely "helpful," to stockholders.

Magellan Health followed the typical M&A mootness process to the proverbial "T." In 2019, *Magellan Health* engaged in a sales process in which 34 potential acquirers were contacted, "24 of whom entered into confidentiality agreements containing don't-ask-don't-waive provisions." Although the process resulted in an agreement to sell a subsidiary, there was no offer made to acquire the company as a whole.

In 2020, one of the 2019 suitors reappeared. The board agreed to engage with that suitor on an exclusive basis, given the recency of the failed 2019 process and the information it provided about other bidders' apparent disinterest. On January 4, 2021, a merger agreement was executed. On February 19, 2021, the company issued its proxy statement. And on March 9, 2021, a stockholder plaintiff sued, seeking expedition and to enjoin the March 31, 2021 stockholder vote. The rationale? That five confidentiality agreements, still in

After Magellan Health, the go-forward expectation is that a mootness fee award will be predicated on the additive information in supplemental disclosures being "material," not merely "helpful," to stockholders.

⁵ The following Sidley lawyers contributed to the research and writing of the pieces in this section: Elizabeth Y. Austin, Sonia Gupta Barros, Nicole Booth, Colleen Theresa Brown, Vadim Brusser, Fiona Collins, Laura Collins, Estelle Georges-Nason, Claire H. Holland, Alex J. Kaplan, Lauren Keane, Charlotte K. Newell, Jamie Sadler, Heather Benzmillier Sultanian, and summer associate Andrea Lofquist. 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.

effect from the 2019 process, contained so-called “don’t-ask-don’t-waive” provisions that tainted the sales process.

On March 19, 2021, 10 days after filing the complaint, having neither prosecuted his one-page expedition motion nor obtained any discovery, the plaintiff agreed to dismiss the litigation as moot. This recognized that Magellan Health had since (1) waived three don’t-ask-don’t-waive provisions (while retaining one provision that its board believed to be in the company’s best interest) and (2) issued supplemental disclosures describing the “history and the terms” of those provisions, their purpose, and the waiver agreement. Having mooted the litigation, however, the company and the plaintiff’s counsel were unable to agree on a mootness fee—a reward for the putative “corporate benefit” counsel obtained via the litigation. Plaintiff’s counsel sought an “eye-popping” \$1.1 million fee. The company countered that a fee of \$75,000 to \$125,000 was appropriate.

On June 6, 2023, in an unpublished transcript ruling, the Court sided with Magellan Health and awarded \$75,000 in fees—the bottom end of what the company had argued was appropriate. Two law school faculty members filed papers as *amici curiae* and “urged that [the Court] issue a written decision to warn other courts applying Delaware law of these policy dangers.” Consequently, on July 6, 2023, Chancellor McCormick issued a written [Opinion](#) explaining the reasoning behind the \$75,000 award.

Despite the prevalence of mootness fees, *Magellan Health* is one of the few opinions that provides a meaningful examination of the considerations attendant to a mootness fee award. It is a must-read for practitioners (and, ultimately, courts) across the country faced with determining an appropriate mootness fee in matters concerning a Delaware entity.

A few takeaways from the Court’s rationale in awarding \$75,000 and rejecting the requested \$1.1 million fee:

- *Heightened Materiality Standard for Supplemental Disclosures Going Forward.* The Court indicated that it would “award mootness fees based on supplemental disclosures only when the information is material.” This is a departure from prior Chancery Court precedent (specifically, *Xoom*), which had held that “helpful” information could warrant a fee award.

But the Court did not apply this new standard to *Magellan Health*, holding it would be unjust to apply this new, heightened standard in the immediate case because it was not briefed by the parties. The Court found that the supplemental disclosures were “marginally helpful” and therefore awarded a \$75,000 fee—the bottom end of what Magellan Health had argued appropriate.

- *The “Benefit” of Loosened Deal Restrictions Must Be Analyzed in Context.* Plaintiff’s counsel pointed to precedent awarding seven-figure fees to counsel that had challenged don’t-ask-don’t-waive restrictions. But the Court viewed these as inapposite. The Court explained that the precedent had not created a one-size-fits-all approach but rather that the value of loosened deal restrictions was “the incremental amount that stockholders would receive if a higher bid emerged” and that a plaintiff could only “take credit for the increased likelihood of a topping bid.”

Counsel’s fee request unraveled because they could not demonstrate an “increased likelihood of a topping bid” due to their efforts. The three don’t-ask-don’t-waive waivers all pertained to entities preliminarily involved in the 2019 sales process that had not “expressed any serious interest” in a deal. The Court consequently found that the “increased likelihood of a topping bid was close to zero. The resulting equation is lawyer-friendly: zero multiplied by anything is zero. So the waivers do not justify a fee award.”

- *Beware Pre-Trulia Precedent.* The Court highlighted that certain doctrinal shifts—including the 2016 *Trulia* decision—caused a decline in settlements and fee awards. The Court explained that this “renders pre-*Trulia* precedent less useful in determining the value of

If federal courts apply Magellan Health consistently, it would be logical to expect that the “merger tax” litigation that has been pushed to federal courts will be filed less frequently.

otherwise comparable benefits.” The Court flagged this as a “warning”: “Often, pre-*Trulia* precedent pricing corporate benefits reflect inflated valuations and warrant careful review.”

- **Guidance Relevant to Courts Nationwide.** The Court explicitly wrote the opinion to offer guidance to other courts applying Delaware law and determining fee awards. In so doing, the Court recognized that recent Delaware law developments (e.g., the 2016 *Trulia* decision) had pushed substantial M&A litigation volume to disparate federal courts, which hear a wider array of cases and likely do not “have access to the transcripts” in which Delaware courts typically address fee disputes.
- **Perhaps Less Litigation to Come.** A cynic might argue that the prospect of a lower (or no) fee award for counsel will limit the number of claims filed. We will have to wait and see. But if federal courts apply *Magellan Health* consistently, it would be logical to expect that the “merger tax” litigation that has been pushed to federal courts will be filed less frequently.

The Culture Wars Come For DGCL Section 220

In June, in [Simeone v. The Walt Disney Company](#) (Del. Ch. Jun. 27, 2023), the Delaware Chancery Court rejected a lawsuit by a Walt Disney Company stockholder to compel inspection of its books and records relating to the company’s opposition to Florida House Bill 1557. Though this case was in some ways quite routine—it rested on a straightforward application of the long-settled standard for a Delaware General Corporation Law (DGCL) Section 220 demand—the political subtext underlying the inspection demand was anything but ordinary.

Disney has a substantial presence in Florida due to its Walt Disney World Resort, which makes it one of the largest employers in the state. On February 24, 2022, the Florida House of Representatives voted to approve House Bill 1557, titled the Parental Rights in Education bill, “which limits instruction on sexual orientation or gender identity in Florida classrooms.” It is better known as the “Don’t Say Gay” bill, and it fanned the flames of a culture war across the state and the nation last year. After the bill’s approval in the House, many of Disney’s employees and creative partners demanded Disney take a public stand against it. Disney eventually spoke out against the legislation, and in response, Florida’s legislature voted to dissolve the special tax district that encompasses Walt Disney World Resort.

It was in this political environment that a “longtime Disney stockholder” was solicited by counsel to serve a books and records demand upon Disney, asserting that the company’s directors and officers may have breached their fiduciary duties to the company and its stockholders by opposing the bill. Though Disney believed the stockholder lacked grounds to obtain books and records, Disney produced certain board minutes and corporate policies. The stockholder, dissatisfied with the documents he received, filed litigation.

In a post-trial opinion, the Court denied the stockholder’s request for a further inspection of Disney’s books and records and held that (1) the stated purpose for the inspection request was not the stockholder’s own purpose, (2) the stockholder failed to establish a proper purpose for inspection, and (3) in any event, no further inspection would be warranted as the stockholder had been given essential books and records.

The Court first held that the stockholder had not established a proper purpose for his inspection demand because the stated purpose belonged to the stockholder’s counsel, not the stockholder himself. The alleged stated purpose was to “[t]o investigate potential wrongdoing, mismanagement and breaches of fiduciary duties...in connection with the Company’s decision to publicly oppose the Parental Rights Act.” But the stockholder testified that he did not consider pursuing litigation or making an inspection demand after learning about HB 1557. Instead, he made an inspection demand only after he had been

The Simeone decision demonstrates that Delaware courts continue to require that Section 220 demands be driven by actual stockholder interests, not by the causes and interests of counsel or special interest groups.

solicited by an attorney connected to the Thomas More Society, a “public interest law firm championing Life, Family, and Freedom.” Further, the stockholder testified that his only purpose in requesting to inspect Disney’s books and records was to “know the person or persons who were responsible for making th[e] political decision at Disney to publicly oppose” the law. Thus, the Court held that the inspection demand did not address “the plaintiff’s own interests as a stockholder.”

Second, the Court determined that the inspection demand was not motivated by a proper corporate purpose, as the stockholder failed to provide a credible basis from which to infer possible wrongdoing. In the Court’s view, the stockholder “was not describing potential wrongdoing”; he was “critiquing a business decision” to speak on a public policy issue.

Third, and finally, the Court held that the stockholder did not meet his burden to prove that the records he sought were “essential” to the purpose of his inspection demand. In doing so, the Court followed ordinary practice in Delaware “not [to] order emails to be produced when other materials (e.g., traditional board-level materials, such as minutes) would accomplish the petitioner’s proper purpose.” Because Disney provided all board materials related to the bill and its response to the legislation, as well as the potential loss of the special tax district, the stockholder had all necessary and essential information.

The *Simeone* decision does not break new ground on the application of Delaware law on books-and-records demands. But it does demonstrate that the Section 220 standard has real teeth and cannot be used by lawyers with a social or political agenda to fish for ammunition in the absence of any credible allegation of actual wrongdoing. Delaware courts continue to require that Section 220 demands be driven by actual stockholder interests, not by the causes and interests of counsel or special interest groups.

Entire Fairness Does Not Require Perfection

The Delaware Supreme Court recently held in [In re Tesla Motors Stockholders’ Litigation](#) (Del. Jun. 6, 2023) that an entire fairness analysis does not require perfection so long as the acquisition itself was the result of fair dealing and fair price. Practitioners and boards engaging with a potentially conflicted transaction would be well served to study this opinion with care, particularly where the potential acquiror cannot (or chooses not to) employ a special committee of independent directors to handle negotiations.

In *Tesla*, the Delaware Supreme Court considered an appeal of former Vice Chancellor Joseph R. Slight’s post-trial ruling that Tesla CEO and board member Elon Musk (a 22% owner of Tesla shares) did not cause Tesla to overpay for SolarCity, an entity founded by Musk’s cousins and in which Musk held a substantial investment. The ruling is particularly significant because the Court engaged with at least 11 flaws in Tesla’s process that the Chancery Court had identified. Like the Chancery Court, the Supreme Court held that various other positive factors amply outweighed those flaws and affirmed the lower court’s finding that the transaction satisfied entire fairness.

The flaws included that Tesla’s board was presumed conflicted, did not employ a special committee, and did not fully exclude Musk when analyzing the potential transaction, instead allowing Musk to have a voice in the selection of advisors and to participate in certain meetings. But ultimately, like the Chancery Court, the Supreme Court held that substantial evidence demonstrated that Tesla’s acquisition of SolarCity was entirely fair, including (1) because the negotiations were led by a highly credible, independent director; (2) Tesla undertook substantial diligence on the matter and reduced its offer price as it received additional information; (3) Tesla rejected a number of Musk’s requests concerning SolarCity; and (4) upon closing, Tesla was able to book a profit from the transaction. Further, both

The Tesla decision is particularly significant because the Delaware Supreme Court engaged with at least 11 flaws in Tesla's process that had been identified by the Delaware Chancery Court. Like the Chancery Court, the Supreme Court held that various other positive factors amply outweighed those flaws and affirmed the lower court's finding that the transaction satisfied entire fairness.

Courts took meaningful note that the transaction included a majority-of-the-minority voting provision and that Tesla stockholders voted overwhelmingly in favor of it.

In affirming the trial court ruling, the Delaware Supreme Court rejected the appellants' contention that 11 flaws in Tesla's process—particularly the absence of a special committee of independent directors, conflicted board, and Musk's presence during a critical board meeting regarding price—automatically required a ruling against Musk. The Court explained that while the use of a special committee and a favorable majority-of-the-minority vote would have entitled the transaction to the deferential business judgment standard of review under the Delaware Supreme Court's 2014 decision in *Kahn v. M & F Worldwide Corp. (MFW)*, the lack of such procedural protections did not require a finding of unfair process. Rather, the Court reiterated to boards and stockholders that even under Delaware's demanding entire fairness standard, "a finding of perfection is not *sine qua non* in an entire fairness analysis." "The paramount consideration...is whether the price was a fair one."

The Delaware Supreme Court took particular note of the lower court's finding (1) that "the credible evidence produced at trial shows" that "the Tesla Board meaningfully vetted the Acquisition" and demonstrably "operated independently of Musk," including insisting on "a walkaway right in the event of a SolarCity debt covenant breach"; (2) that Musk "did not impede the Tesla Board's pursuit of a fair price" or otherwise "exercise his purported control over the Tesla Board with respect to the acquisition"; and (3) that the transaction included a majority-of-the-minority stockholder vote provision. Instead, the Tesla board invited Musk to join for certain strategic meetings because it believed that Musk's "perspective[] regarding the solar industry and SolarCity, in particular, would be helpful."

With respect to price, the Supreme Court recognized that "where there are process infirmities, the Court is obliged to study fair price even more carefully." The Court also acknowledged the lower court's determination that Musk presented the most persuasive evidence regarding SolarCity's value and fairness of the price Tesla paid to acquire it. In contrast, appellants had proffered only "incredible" testimony that SolarCity was insolvent (and not any other analysis regarding price).

It bears noting that the Delaware Supreme Court did agree with appellants that the lower "court 'failed to determine SolarCity's value at the time the Acquisition closed' and instead improperly compared SolarCity's stock price from June 21, 2016 [the day Tesla's initial offer to SolarCity was publicly announced] to its stock price right before the November 21, 2016 closing," which had not yet factored in nonpublic information. Nevertheless, the Supreme Court ruled that this was not reversible error due to ample support in the record regarding the fairness of the price.

After *Tesla*, it remains the case that for controller buyouts or other conflicted transactions, boards should consider applying the *MFW* doctrine, so that they may benefit from the highly deferential business judgment standard of review, *i.e.*: (1) the controller conditions the procession of the transaction on the approval of both a special committee and a majority of the minority stockholders, (2) the special committee is independent, (3) the special committee is empowered to freely select its own advisors and to say no definitively, (4) the special committee meets its duty of care in negotiating a fair price, (5) the vote of the minority is informed, and (6) there is no coercion of the minority.

But if circumstances preclude utilizing a special committee or if *MFW* processes are not put in place, boards and advisors should be making real-time decisions mindful of the likely application of the entire fairness standard if litigation follows. Indeed, as the Delaware Supreme Court observed, "[h]ere, the price of not utilizing a special committee was being subjected to entire fairness review—an expensive, risky, and 'heavy lift' in the litigation arena."

Of course, every circumstance will be unique, but process points that boards should consider include:

- requiring a majority-of-the-minority voting provision
- tasking strong and careful independent directors to take the lead in negotiations
- taking affirmative steps that may show in the event of a challenge that the board operated independently of the controller; such steps may include, depending on the circumstances, (1) undertaking deep diligence over an extended time, (2) rejecting requests from the controller, (3) ensuring that the opportunity aligns with the company's business plan, (4) implementing a walkaway right in the event of certain financial breaches, (5) employing independent advisors that closely study potential prices for negotiation, and (6) revisiting whether an offer price should be adjusted in the face of additional information.

Caesar's Wife: How a Single-Member Special Litigation Committee Can Avoid Reproach

The Delaware Chancery Court [recently granted](#) a motion by a single-member special litigation committee to terminate a stockholder derivative suit. Vice Chancellor Lori W. Will found that the one-member special litigation committee conducted a good faith investigation and reached reasonable conclusions regarding the transactions at issue. The opinion demonstrates that the Court's oversight of a single-member special litigation committee will be rigorous, and it offers valuable practice points for future single-member committees.

In 2017, Baker Hughes, an oilfield services company, merged with General Electric's oil and gas division. GE acquired a majority of Baker Hughes's stock along with the power to control a majority of the board of directors. The merger involved a two-year lockup agreement whereby GE could not sell its Baker Hughes stock without Conflicts Committee approval. Shortly thereafter, GE experienced liquidity challenges and wanted to raise cash through asset sales. Because of the lockup agreement, after lengthy negotiations, the entities agreed to a multibillion-dollar separation agreement that allowed GE to sell its majority stake in Baker Hughes.

In early 2019, stockholders filed a consolidated derivative action seeking more than \$1 billion, arguing that GE, driven by a need for liquidity, exercised control over Baker Hughes in order to force the company to agree to transactions that unfairly favored GE. After a motion to dismiss was granted only in part, the Baker Hughes board formed a special litigation committee (SLC). The SLC consisted of a single independent and disinterested director, who in turn retained independent legal and financial advisors. The SLC's investigation lasted nine months and involved over a dozen minuted meetings. The investigation culminated in a written report detailing the SLC's factual assessments, the applicable legal standards, the merits of plaintiffs' claims, and other factors considered by the SLC. The SLC determined that it was in the best interests of the company and its stockholders to terminate the derivative action and filed a motion to that effect. Plaintiffs then pursued discovery to test the independence, good faith, and reasonableness of the SLC's investigation and its conclusions. The Court granted the SLC's motion to terminate, but only after motion practice, oral argument, and live testimony from the sole SLC member.

Under Delaware law, an SLC's decision to terminate litigation is subject to review under a two-step analysis. The first step is a review of the independence and good faith of the SLC member(s) and an inquiry into whether the SLC conducted a reasonable investigation capable of supporting its own conclusions. This inquiry is "broad and nuanced" when applied to single-member SLCs: that person should, like "Caesar's wife, be above reproach." *Lewis v. Fuqua*, 502 A.2d 962, 967 (Del. Ch. 1985). The second step of the analysis is discretionary and allows the Court to apply its own business judgment to the SLC's conclusions.

Vice Chancellor Will's first-step independence analysis centered largely on communications between the sole committee member and the chairman of the Baker Hughes board. Plaintiffs pointed to three sets of communications as evidence of the committee member's

The Baker Hughes opinion demonstrates that the Court's oversight of a single-member special litigation committee will be rigorous, and it offers valuable practice points for future single-member committees.

Special litigation committee members should be mindful of their communications with others on the board and should generally not discuss the committee's work with non-members.

partiality, and the Court examined each email and text message in great detail, noting that "certain of these communications should not have occurred" but nevertheless granted the motion.

The first set of communications involved emails and a text message between the SLC member and the board's chairman regarding a potential expansion of the board. Such an expansion would possibly have allowed the SLC to add additional members. The Court evaluated these emails in light of contemporaneous communications between the SLC and its counsel and the committee member's live testimony that the purpose of these messages was purely logistical. The committee member "credibly testified" that the purpose was to understand the timing of any potential board expansion, as a new committee member would need to be brought up to speed, and the litigation stay already needed to be extended in order for the SLC to complete its process. There was perhaps some irony in plaintiff's challenge to these communications: adding new, outside directors with no role in the challenged events would seem to improve, rather than hinder, the process.

Plaintiffs also challenged two sentences of an email thread between the committee member and chairman discussing pandemic planning. The committee member noted that a remote SLC interview had a "good outcome." The Court ultimately found this phrase to refer to overcoming internet connection complications rather than to the substance of the SLC's investigation but noted that the SLC member "undoubtedly" did not have a reason to discuss the interview in the first instance.

Finally, plaintiffs flagged a text message from the SLC member to the chairman that mentioned an SLC meeting and ended with "Thanks for the wine!" The Court noted that all Baker Hughes board members received wine as part of virtual social events during the pandemic, and therefore such a remark did not go to the committee's independence.

Together, the Court's careful parsing of these communications illuminates a set of ground rules for committee member communications. SLC members should be mindful of their communications with others on the board and should generally not discuss the committee's work with non-members. Any concerns in this space are best discussed with counsel. Indeed, where a reference to the SLC's work is absolutely essential for logistical planning purposes, the communication should clearly identify the logistical need and clearly limit the communication to that need. As this case illustrates, innocuous social events such as virtual happy hours that involve *de minimis* gifts to the entire board likely do not jeopardize the board member's independence, but they increase litigation risk and highlight the reasons to avoid such discussion if possible.

The *Baker Hughes* opinion also provides guidance on the thoroughness of a committee's final report. Plaintiffs pointed to the SLC report's failure to discuss potential conflicts that certain board advisors allegedly had during the disputed transactions. The Court concluded that the report's "silence" on this issue was "unfortunate" but "not fatal," as the SLC was ultimately able to demonstrate that it reviewed relevant documents and inquired into the potential conflicts. The length of the Court's discussion demonstrates the importance of including all lines of inquiry and investigation in the report itself. Inclusion of this portion of the committee member's investigation would likely have obviated the need for additional discovery and live testimony on the topic in subsequent litigation.

This case demonstrates that a court will carefully examine the work of a special litigation committee, particularly one with a single member. If plaintiffs challenge communications between the committee member and defendants, the court may compare each communication, no matter how brief, to witness testimony and documentary evidence, including communications with counsel and interview notes. Likewise, if plaintiffs challenge the thoroughness of an investigation, the court will likely examine the number of hours spent, documents reviewed, and interviews conducted as well as the substance of the report. In this case, the Court even reviewed the number of interviews (2 out of 22) that the

sole committee member was unable to attend due to scheduling conflicts. Few, if any, of the plaintiffs' critiques were given short shrift, with the Court addressing even those contentions it considered "scattershot." But the opinion also reiterates the important role that special litigation committees play in corporate governance, and the prospect that a well-functioning committee's work can change the outcome of a derivative suit.

LEGISLATIVE DEVELOPMENTS

2023 DGCL Amendments Eliminate the Stockholder Approval Requirements for Certain Stock Splits and Streamline the Process for Ratifying Defective Corporate Acts

Delaware Governor John Carney signed into law amendments to the DGCL on July 17, 2023. The amendments, which took effect on August 1, 2023, have implications for companies incorporated in Delaware. Certain key amendments are summarized below.

Stockholder Vote Requirements for Stock Splits. A corporation seeking to amend its certificate of incorporation to increase or decrease the number of shares authorized for issuance must do so in accordance with DGCL Section 242. New DGCL Section 242(d) eliminates the stockholder approval requirements for charter amendments for certain forward stock splits and reduces the stockholder vote required for charter amendments for reverse stock splits. As amended, DGCL Section 242(a)(3) requires that reclassifications of outstanding stock apply to all issued shares, whether outstanding or held in treasury.

New DGCL Section 242(d)(1) provides that no stockholder vote is required for forward stock splits where (1) the class of split stock is the sole class of the corporation's capital stock outstanding and (2) the corporation's capital stock is not divided into series. That is, a company may amend its charter without a stockholder vote to subdivide a class of issued shares if the corporation has only one class of stock that is not divided into series. A corresponding amendment allows for increases in the authorized number of shares up to an amount proportionate to the subdivision without stockholder approval.

Under new DGCL Section 242(d)(2), charter amendments to effect a reverse stock split will require approval only by a majority of votes cast as a single class, rather than a majority of the outstanding shares, if (1) the class is listed on a national securities exchange immediately prior to the amendment becoming effective and (2) the corporation meets the exchange's listing requirements for the minimum number of holders immediately after the amendment becomes effective. Thus, new DGCL Section 242(d)(2) reduces the stockholder voting requirements for companies seeking to effect charter amendments to increase or decrease the number of authorized shares of a class other than in connection with forward stock splits.

Companies wishing to avoid these new default rules may expressly opt out of the provisions of DGCL Section 242(d) in their certificate of incorporation or state that the majority vote of outstanding stock, otherwise required by DGCL Section 242(b), is required to adopt any charter amendment specified in DGCL Section 242(d).

Ratification of Defective Corporate Acts. Amendments to DGCL Section 204 simplify the process for ratifying certain defective corporate acts. New DGCL Section 204(e) will eliminate the requirement to file a certificate of validation with the Delaware Secretary of State where (1) the underlying defective corporate act required filing a certificate under another DGCL section and (2) the certificate was filed and required no change to give effect to the defective corporate act. When certificates of validation are required, the amendments simplify the contents.

The amendments also clarify the procedural requirements. New DGCL Sections 204(c)(2) and 204(d) clarify that all holders of valid stock outstanding and entitled to vote at the time the board of directors adopts resolutions ratifying the defective corporate act may vote on the ratification.

New Safe Harbor for Mortgaged or Pledged Assets. As amended, new DGCL Section 272 provides that no vote of stockholders is required to authorize a sale, lease, or exchange of collateral securing a mortgage or pledge if the secured party can sell such assets without the corporation's consent under the law governing the mortgage or pledge or other applicable law. A secured party and a corporation may also agree, with board approval, to an alternative transaction relating to collateral assets without a stockholder vote when the value of the collateral assets does not exceed the amount of liabilities or obligations reduced or eliminated as a result of the transaction. The new safe harbors under DGCL Section 272 apply when stockholder approval is not required under DGCL Section 271, and secured parties remain obligated to comply with Article 9 of the Uniform Commercial Code, real property law and other laws, as applicable.

Transfer, Domestication, or Continuance to Non-U.S. Entities and Appraisal Rights. Amendments to DGCL Section 390(b) reduce the votes required for approval of a transfer, domestication, or continuance of a Delaware corporation to a non-U.S. entity. Previously, such actions required a unanimous vote of all stockholders, whereas the amendments require only a majority in voting power of the outstanding stock entitled to vote.

In connection with the amendments to DGCL Section 390, an amendment to DGCL Section 262 provides that statutory appraisal rights are available in connection with a transfer, domestication, or continuance of a Delaware corporation to a non-U.S. entity, with certain exceptions. The amendments to DGCL Section 262 are effective for mergers consummated pursuant to agreements entered into, as well as conversions, transfers, domestications, or continuances effected, on or after August 1, 2023.

CORPORATE GOVERNANCE DEVELOPMENTS

Nasdaq Updates Listing Standards Relating to Code of Conduct Waivers

On September 5, 2023, the SEC [approved](#) amendments to [Nasdaq Listing Rules 5610](#) and IM-5610 relating to code of conduct waivers. As amended, the rules allow the board or a *board committee* (as opposed to just the full board as previously required) to approve any waivers of the code of conduct for directors or executive officers. The amended listing rules also require Nasdaq-listed foreign private issuers to disclose such waivers *within four business days* in a press release, on a Form 6-K, or on the company's website. Previously, a foreign private issuer could wait until the next Form 20-F or 40-F filing to disclose a waiver. The Nasdaq rule changes now align with the NYSE listing standards on code of conduct waivers in [NYSE Listed Company Manual Section 303A.10](#). Nasdaq-listed companies should consider any advisable updates to their codes of conduct or board committee charters in light of this development.

SEC DEVELOPMENTS

SEC Adopts Final Cybersecurity Disclosure Rules for Public Companies

On July 26, 2023, the U.S. Securities and Exchange Commission (SEC) [finalized](#) its rule on Cybersecurity Risk Management, Strategy, Governance, and Incident Disclosure by Public Companies (the Final Rule), which took effect on September 5. The Final Rule applies to all public companies subject to the reporting requirements of the Securities Exchange Act of 1934, including foreign private issuers (FPIs) and smaller reporting companies, and will require disclosure of material cybersecurity incidents on Form 8-K and Form 6-K and periodic disclosure of cybersecurity risk management, strategy, and governance in annual reports on Form 10-K and Form 20-F.

The final cybersecurity disclosure rules require companies to determine the materiality of an incident “without unreasonable delay,” which may pose significant challenges and risks in the midst of responding to an active incident.

The Final Rule substantially adopts the SEC’s [March 2022 proposal](#) but includes several changes designed, among other things, to minimize the additional cyber risk the proposed disclosures would have imposed. The Final Rule still, however, reflects an important change. For one thing, it will require an unprecedented level of disclosure into the management of a particular risk. Additionally, the Final Rule requires companies to determine the materiality of an incident “without unreasonable delay,” which may pose significant challenges and risks in the midst of responding to an active incident.

Key Requirements

- **Material Cybersecurity Incident Disclosure.** Companies must disclose a material cybersecurity incident, including the material aspects of its nature, scope and timing, and material impact or reasonably likely material impact, through Form 8-K within four business days of a determination of materiality unless they have received a written determination from the U.S. Attorney General that there is a “substantial risk to national security or public safety.” We expect that such determinations from the Attorney General will be rare. FPIs also must disclose material cybersecurity incidents on Form 6-K that they disclose or publicize elsewhere.
 - *The Legal Standard for Materiality Has Not Changed.* Notably, the Final Rule has not changed the law of materiality. Materiality is defined in the adopting release as consistent with the definition of materiality under the securities laws, that is, where there is a “substantial likelihood that a reasonable shareholder would consider it important in making an investment decision” or it would have “significantly altered the total mix of information made available.”⁶ However, the Final Rule states that determinations of materiality must be undertaken “without unreasonable delay,” although the adopting release clarifies that the Final Rule does not specify whether the materiality determination should be performed by the board, a board committee, or one or more officers and that companies “may establish a policy tasking one or more persons to make the materiality determination.”
- **“Related” Immaterial Cybersecurity Incidents.** The SEC omitted the proposed general aggregation of immaterial cybersecurity incidents for materiality analysis unless they are “related.” The SEC emphasized that the term “cybersecurity incident” should be construed broadly and that as defined, it “extends to ‘a series of *related* unauthorized occurrences’ ” (emphasis added).
- **Cybersecurity Risk Management and Strategy.** On Form 10-K or Form 20-F, a company must describe its processes, if any, for assessing, identifying, and managing material risks from cybersecurity threats. In doing so, the company must also disclose, as applicable,
 - whether and how the described processes have been integrated into the company’s overall risk management system or processes
 - whether the company engages assessors, consultants, auditors, or other third parties in connection with any such processes
 - whether the company has processes to oversee and identify material risks from cybersecurity threats associated with its use of any third-party service provider

In addition, companies must disclose whether any risks from cybersecurity threats, including as a result of any previous cybersecurity incidents, have materially affected or are reasonably likely to materially affect the company.

- **Board and Management Governance.** On Form 10-K or 20-F, a company must describe its board of directors’ oversight of risks from cybersecurity threats, including identifying any board committee or subcommittee responsible for such oversight and describing the processes by which the board or such committee is informed about such risks. Companies

⁶ TSC Indus. v. Northway, 426 U.S. 438, 449 (1976).

Companies should immediately update their incident response plans and other necessary processes to ensure that a timely determination can be made regarding the materiality of cybersecurity incidents and consider specific processes and procedures to evaluate materiality throughout and beyond the lifecycle of an incident response.

must also describe management's role and expertise in assessing and managing material risks from cybersecurity threats and address

- whether and which management positions or committees are responsible for assessing and managing such risks and their relevant expertise
- the processes by which such persons or committees are informed about and monitor the prevention, detection, mitigation, and remediation of cybersecurity incidents
- whether such persons or committees report information about such risks to the board of directors or a committee or subcommittee of the board of directors

In a change from the proposed rules, the Final Rule does not require companies to disclose the cybersecurity expertise of any individual director.

Compliance Dates

Compliance with the new requirement to disclose material cybersecurity incidents on Form 8-K or 6-K begins on December 18, 2023 for all companies other than smaller reporting companies, which must comply beginning on June 15, 2024. The requirement to disclose cybersecurity risk management, strategy, and governance in annual reports will begin with annual reports for fiscal years ending on or after December 15, 2023. For a calendar-year-end company, the 2023 Form 10-K (or Form 20-F) filed in early 2024 will need to include the new disclosures.

Key Action Items for Companies

- Companies should develop an understanding of the cybersecurity requirements and concepts in the Final Rule. At a minimum, we urge companies to carefully review the chart set forth on page 12 of the [adopting release](#) as well as the [Fact Sheet](#) published by the SEC.
- Companies should immediately update their incident response plans and other necessary processes to ensure that a timely determination can be made regarding the materiality of cybersecurity incidents and consider specific processes and procedures to evaluate materiality throughout and beyond the lifecycle of an incident response.
- Companies should review existing cybersecurity risk management, strategy, and governance practices in light of the new cybersecurity disclosure obligations that will affect upcoming annual reports on Forms 10-K and 20-F.

For more information, see the Sidley Update titled [U.S. SEC Public Company Cybersecurity Disclosure Regulation Finalized With Swift Effective Date](#).

Roundup of Recent SEC Enforcement Actions

In recent months, the SEC's Enforcement Division has brought a flurry of enforcement actions against public companies. We have highlighted some of the more notable actions below, which serve as a reminder for companies to ensure that their disclosures are accurate and complete and that their disclosure controls are adequate. Companies should also consider their agreements with current and former employees and delete any language that purports to restrict employees from communicating with government agencies.

Inadequate Related Person Transaction Disclosures

- On September 18, 2023, the SEC [announced](#) charges against a ride sharing company for failing to disclose that one of its directors received millions of dollars for brokering a shareholder's sale of roughly \$424 million worth of shares of company stock before the company went public. The SEC's order found that the company violated Exchange Act Section 13(a) and Rule 13a-1 by failing to make the required disclosure in its 2019 Form 10-K. The company settled the enforcement action for a civil penalty of \$10 million,

without admitting or denying the SEC's allegations.

- On September 11, 2023, the SEC [announced](#) that it had taken enforcement action against Maximus, Inc. for failing to disclose that two siblings of one of the company's executive officers were also employed by the company. Each sibling received annual compensation of more than \$120,000, meaning Maximus was required to disclose the employment arrangements with the executive officer's siblings in its proxy annual SEC filings under Regulation S-K Item 404. The SEC's [order](#) found that Maximus violated Exchange Act Sections 13(a) and 14(a) and Exchange Act Rules 13a-1 and 14a-3 by failing to make the required disclosures in its annual reports for fiscal years 2019 through 2021. Maximus settled the enforcement action for a civil penalty of \$500,000, on a neither-admit-nor-deny basis.

Insufficient Descriptions of Reasons for Late SEC Filings

- Under Exchange Act Rule 12b-25, if a public company is unable to file a periodic report on time, it must file with the SEC a Form 12b-25 "Notification of Late Filing" (or Form NT) no later than one business day after the report's due date. The Form NT must describe why the company cannot file the periodic report on time and explain any anticipated, significant changes in the company's results of operations from the corresponding period for the last fiscal year. On August 22, 2023, the SEC [charged](#) five public companies with violating Section 13(a) and Rule 12b-25 for insufficient disclosures in their Form NT filings. The SEC found that each company announced restatements or revisions to financial reporting within 3 to 21 days of their Form NT filings despite failing to disclose that anticipated restatements or revisions were a primary reason why the company was unable to file the periodic report on time. The SEC also found that the companies failed to disclose that management anticipated significant changes in results of operations and provide an explanation of the changes as required by Form NT. Without admitting or denying the SEC's allegations, each targeted company agreed to settle the SEC's charges and pay civil penalties in amounts ranging from \$35,000 to \$60,000. The proceedings follow an enforcement sweep in April 2021 when the SEC charged eight public companies for similar violations.

Deficient Disclosures About Executive Perks

- On June 20, 2023, the SEC [announced](#) that it had agreed to settle charges against a tools company for failing to disclose at least \$1.3 million worth of perquisites and personal benefits (e.g., primarily use of the corporate aircraft) that it provided to four executives and one director in 2017 through 2020. The company avoided a civil penalty due to its prompt internal investigation, self-reporting to the SEC, and cooperation with the SEC staff's investigation. The SEC also announced settled charges against one of the company's senior executives for causing the company to violate the proxy solicitation and books and records provisions of the Exchange Act. The SEC's [order](#) finds that the senior executive received compensation consisting of approximately \$280,000 in personal expenses (e.g., chauffeur services, travel items, meals) he charged to the company that was not disclosed in the company's proxy statements. The senior executive did not divulge the perquisites or personal benefits in his D&O questionnaire or when offered the chance to review the company's draft proxy statements. The senior executive also took certain actions (e.g., submitting expense reimbursement requests and approving certain payments to vendors) that resulted in the company improperly recording payments as business expenses rather than compensation for the senior executive. The senior executive settled the enforcement action for a civil penalty of \$75,000 on a neither-admit-nor-deny basis.

The SEC recently charged five companies for failing to disclose in Form NT filings that their request for seeking a delayed Form 10-Q or 10-K filing was caused by an anticipated restatement or revision of prior financial reporting.

Employee Agreements That Impede Whistleblowing

- On September 19, 2023, the SEC [announced](#) that it settled charges against a commercial real estate company for using an employee release that violated the SEC's whistleblower protection rule. The SEC's [order](#) found that from 2011 to 2022, the company required employees to sign a release attesting that they had not filed a complaint about the company with any federal agency as a condition to receiving severance pay, which impeded potential whistleblowers from reporting complaints to the SEC. Without admitting or denying the SEC's allegations, the company agreed to pay a \$375,000 civil penalty. The SEC commended the company for its cooperation with the SEC staff and extensive remedial action, including revising its forms of employee release and contacting more than 800 employees who had signed the release and clarifying their ability to notify the SEC staff about potential securities law violations. Two weeks earlier, the SEC [announced](#) a settlement with a privately held energy and technology company on similar charges. In that case, the company agreed to notify former employees who had signed a separation agreement that the SEC found impeded whistleblowing and also pay a \$225,000 civil penalty.

SEC Division of Corporation Finance Publishes Sample Comments on Deficient XBRL Disclosures

The SEC requires public companies to tag certain financial and other information in their SEC filings in eXtensible Business Reporting Language (XBRL) format to make the data more accessible and comparable. Earlier this month, the SEC's Division of Corporation Finance published an [illustrative letter](#) with sample comments the Division staff may issue to public companies if it finds their XBRL or Inline XBRL disclosures deficient, depending on the facts and circumstances and filing type.

The sample comments, which should not be considered an exhaustive list, include the following:

Item 405 of Regulation S-T

1. Your filing does not include the required Inline XBRL presentation in accordance with Item 405 of Regulation S-T. Please file an amendment to the filing to include the required Inline XBRL presentation.

Cover Page

2. The common shares outstanding reported on the cover page and on your balance sheet are tagged with materially different values. It appears that you present the same data using different scales (presenting the whole amount in one instance and the same amount in thousands in the second). Please confirm that you will present the information consistently in future filings.

Pay versus Performance

3. Disclosure under Regulation S-K Item 402(v) must be in Inline XBRL, in accordance with Item 405 of Regulation S-T and the EDGAR Filer Manual. Please ensure that you have provided the appropriate Inline XBRL tagging for all the required Item 402(v) data points.
4. Refer to the [relationship disclosures] graph. Although it is permissible to combine one or more sets of relationship disclosures under Regulation S-K Item 402(v)(5) into one graph, table, or other format, note that you must still provide separate XBRL tags for each required item. Please ensure that you have provided the appropriate Inline XBRL tagging for all the required Item 402(v) data points.

Financial Statements and Supplementary Data

5. You have used different XBRL elements to tag the same reported line item on the income statement from period to period. Please provide us your analysis as to how you concluded that the results reported necessitated the change in the element. Alternatively, if you conclude that the change from period to period was not necessary to communicate a change in the nature of the line item, confirm that you will ensure that your choice remains consistent for line items from period to period.
6. We note that instead of using an XBRL element consistent with current U.S. GAAP in your income statement, you instead used a custom tag. Custom tags are to be used by filers when an appropriate tag does not exist in the standard taxonomy. See Item 405(c)(1)(iii)(B) of Regulation S-T. Please tell us why the current U.S. GAAP tag is not applicable, or alternatively revise your disclosure, beginning with your next filing, to correctly tag this disclosure.

Public companies should consider these sample comments and other [SEC guidance on Inline XBRL](#) when preparing their XBRL and Inline XBRL disclosures in future filings.

REGULATORY DEVELOPMENTS

FTC Proposes Dramatic Changes to Premerger Notification Process

The Federal Trade Commission (FTC) has [published proposed amendments](#) to the Hart-Scott-Rodino (HSR) premerger notification process that, among other changes, would greatly expand the scope of documents that parties must disclose along with their premerger notification filings, including certain drafts and ordinary course board documents and ordinary course quarterly or semiannual strategic plans. Moreover, parties will need to disclose information regarding their motivations for the transaction as part of the notification process and provide other narrative information about the transaction when disclosing the transaction to federal regulators. Parties would also need to identify all principals, officers, directors, and board observers for all entities they control, not just those within the transaction structure, and would also require identification of any other entity for which these individuals currently serve in similar functions (or have served within the last two years). The proposed rules were subject to a 60-day notice and comment period, which concluded on August 28, 2023. Although extensive comments were received and potential challenges remain, the amendments may take effect as early as the first quarter of 2024.

The proposed premerger notification rules would significantly overhaul and expand the scope of information and documents that parties will be required to produce in their HSR filings. While parties have always potentially been required to produce a vast volume of documents later in the investigation process, this was limited to the relatively small number of transactions that the agencies perceived as potentially anticompetitive, as opposed to all transactions that are notifiable under the premerger notification process as contemplated by the proposed changes. In addition, in the past parties were not required to articulate competitive rationales or synergies as part of the premerger notification process.

As a result, parties will need to involve antitrust counsel at the outset of discussions among businesses, as well as to provide document creation guidance to business leads. This will significantly increase the expense and time associated with putting together the required forms that businesses will need to submit to federal agencies for reportable transactions, along with accompanying documents. Without question, if enacted, the new rules will increase costs and add delay for parties seeking to close ultimately pro-competitive deals. For example, while public companies may ordinarily collect the type of information that they would need to disclose under the proposed rules, they may maintain the information in business units that typically have not previously been involved in the preparation of HSR

The FTC estimates that the proposed changes to the HSR premerger notification process would result in it taking four to six times longer to prepare an HSR filing than under the current process.

filings. And nonpublic companies often do not systematically maintain this type of information, so for them the proposed rule would introduce the need for a new tracking and compliance function.

For more information on proposed amendments, see the Sidley Update titled [The Impact of the FTC's Proposed Changes to Hart-Scott-Rodino Filing Requirements](#).

Interlocking Directorate Enforcement Continues, and FTC Expands Clayton Act's Reach to Noncorporate Entities

On August 16, the FTC [announced](#) a broad [settlement](#) related to a private equity firm's \$5.2 billion acquisition of a natural gas company. To resolve interlocking directorate issues, the settlement included a provision prohibiting the private equity firm from seating anyone on the board of the natural gas company or its top seven competitors in a particular basin. The FTC settlement marked the FTC's first enforcement action applying Section 8 of the Clayton Act—which prohibits interlocking directorates—in 40 years. It also serves as a reminder that agencies examine interlocking directorates in the ordinary course of transaction reviews, in addition to the separate ongoing interlocking directorate investigation initiative being run by the Antitrust Division of the U.S. Department of Justice (DOJ) as discussed in our [September 2022](#) and [December 2022](#) issues of *Sidley Perspectives*.

Notably, in a [statement](#) about the settlement, which applied to acquisition parties that were limited partnerships and limited liability companies, FTC Chair Lina Khan along with fellow Commissioners Rebecca Slaughter and Alvaro Bedoya clarified that the prohibition on interlocking directorates applies to business entities beyond corporations even though Section 8 references only "corporations" and the "Board of Directors." The statement explained: "The proposed order also puts industry actors on notice that they must follow Section 8 no matter what specific corporate form their business takes...Section 8's specific prohibition of interlocks among competitor 'corporations' pre-dates the development of other commonly used corporate structures, such as limited liability companies. Accordingly, we must update our application of the law to match the realities of how firms do business in the modern economy. Today's action makes clear that Section 8 applies to businesses even if they are structured as limited partnerships or limited liability corporations."

The state of Pennsylvania also entered into its own [settlement agreement](#), which largely incorporates the FTC settlement, including with respect to the interlocking directorate issue. The Pennsylvania decree shows that the states are getting involved in interlocking directorate enforcement. While DOJ and FTC enforcement in this space generally leads only to the resignation of directors, the separate state settlement required the defendants to provide for attorney's fees.

Also in mid-August, the DOJ issued a [press release](#) announcing that its separate ongoing director interlock investigations led to an additional two resignations, bringing the number of director resignations due to this recent enforcement initiative to 15 resignations from 11 boards.

DOJ and FTC Take Merger Review in New Direction with Rewrite of Merger Guidelines

In July, the DOJ and the FTC jointly released the long-awaited [2023 Draft Merger Guidelines](#) (the new Merger Guidelines or Draft Guidelines). The new guidelines substantially shift the scope of merger review, as they rewrite the existing guidelines to emphasize more aggressive enforcement and novel antitrust theories of harm. This single set of guidelines will replace all existing merger guidelines (horizontal and vertical) issued by the DOJ and FTC (the Agencies). A 60-day comment period ended on September 18, 2023. While the Agencies will likely not finalize the new Merger Guidelines until next year, it appears that they are already applying the guidelines in their investigations.

*Statement of FTC
Chair Lina Khan:
"Section 8 applies to
businesses even if
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While the DOJ and FTC will likely not finalize the new Merger Guidelines until next year, it appears that they are already applying the guidelines in their investigations.

As expected, the new Merger Guidelines reflect the [Biden administration's](#) goal of "reinvigorated merger enforcement" and are a major rewrite of previous guidelines. As articulated by the Agencies, the goal of the Draft Guidelines is to provide the DOJ and FTC with a flexible set of tools to analyze the competitive impact of transactions in a fast-changing economy and to identify problematic deals that previous guidelines may have missed. The Draft Guidelines also expressly aim to inform "the public, business community, practitioners, and courts" on how the Agencies approach merger analysis, the types of evidence the Agencies consider, and when the Agencies may choose to challenge a transaction.

The new Merger Guidelines are built on 13 separate "principles" that lay out a framework for how the Agencies will evaluate deals. Specifically, a transaction may raise concerns where it implicates one or more of these principles:

1. significantly increases concentration in a highly concentrated market
2. eliminates substantial competition among firms
3. increases the risk of coordination
4. eliminates a potential entrant in a concentrated market
5. creates a firm that controls products or services necessary for rivals to compete
6. creates market structures that foreclose competition
7. entrenches or extends a dominant position
8. furthers a trend toward concentration
9. is part of a series of multiple acquisitions
10. affects competition with respect to a multi-sided platform
11. consolidates competing users of a good, service, or type of worker
12. involves partial ownership or minority interests
13. otherwise substantially lessens competition or tends to create a monopoly

The new Merger Guidelines go on to provide significant detail regarding how the Agencies apply these principles, including the types of evidence that underpin each principle.

In the short term, the Draft Guidelines may not have an obvious impact on merger review because the DOJ and FTC under the Biden administration already use these 13 principles to review mergers. They do, however, for the first time provide key insight into how the Agencies pursue investigations, develop theories of harm, choose to take enforcement action, and argue their cases in court.

Further, the DOJ and FTC have recently used these principles to bring enforcement actions in court with mixed success, especially transactions related to (1) vertical foreclosure of competitors and (2) elimination of potential competition. Until the Agencies begin consistently winning court actions based on these principles, some of the newer principles are less likely to impact merging parties' internal deal calculus.

Significantly, the new Merger Guidelines will not be binding on the courts (which have the ultimate power to block or allow transactions in the U.S.), though courts have often viewed the agency guidelines as "persuasive authority." Courts have historically adopted certain concepts from previous versions of the guidelines—such as the concentration thresholds required to establish a *prima facie* case and the test for supply-side substitutability—both in favor of and against the government position in a particular case, but they are not required to follow the guidelines. In a departure from previous guidelines, which focused more on the Agencies' internal evaluation, the new Merger Guidelines liberally cite to case law developed more than half a century ago, showing how the Agencies plan to argue some of

their more aggressive positions in court and giving parties an opportunity to prepare for those arguments.

The [DOJ](#) and [FTC](#) have both issued press releases regarding the Draft Guidelines further outlining each Agency's commitment to better determine a merger's impact on competition in the current economy. For a discussion of several important takeaways from the Draft Guidelines, see the Sidley Update titled [U.S. DOJ and FTC Take Merger Review in New Direction With Rewrite of Merger Guidelines](#).

SIDLEY RESOURCES

Antitrust/Competition

[Implementing the New EU Subsidies Notification Requirements in M&A Deals](#) (July 26, 2023). On July 12, 2023, the European Union published the [Foreign Subsidies Regulation \(FSR\) Implementing Regulation](#), which clarifies reporting requirements for M&A deals subject to a mandatory notification and the European Commission's powers to investigate and remedy alleged distortions caused by subsidies granted by non-EU countries. Deals meeting certain thresholds and signed after July 11, 2023 will need to be notified from October 12, 2023 if they have not closed by that date. As anticipated in our Sidley Updates for [December 2022](#) and [July 2022](#), it is critical that the FSR requirements and risks are taken into account in deal-making and that parties start preparations as soon as possible as the workload for collecting information necessary for FSR reporting is expected to be significant.

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.

[August Antitrust Bulletin](#) (August 31, 2023). The FTC recently reached a broad settlement with a healthcare technology company that included not only cessation of some allegedly exclusionary conduct but also a prohibition on the company's using noncompete agreements between employers and workers. At the end of July, U.S. Sens. Elizabeth Warren, D-Mass., and Lindsey Graham, R-S.C., proposed that a new U.S. regulatory body be established to regulate big tech and artificial intelligence. The FTC joined the DOJ in enforcing restrictions against interlocking directorates, including the FTC using its powers on this issue in a merger investigation for the first time in 40 years.

[July Antitrust Bulletin](#) (July 25, 2023). The FTC recently proposed significant amendments to the HSR premerger notification process that will radically overhaul the current system increasing the time and cost of filing. The FTC also recently withdrew two policy statements related to its antitrust enforcement in healthcare markets, and two additional commissioners were nominated to join the FTC. The New York State legislature passed a bill that, if signed by Democratic Gov. Kathy Hochul, would prohibit nearly all noncompete agreements between employers and workers going forward, irrespective of occupation or compensation, and give employees a private right of action to challenge unlawful noncompete agreements. The Court of Justice of the European Union ruled that competition authorities can take into account compliance with EU data protection laws when assessing whether there has been an infringement of competition law, and the Belgian national competition authority imposed interim measures halting integration of a completed transaction even though it fell below its thresholds for notification.

[June Antitrust Bulletin](#) (June 29, 2023). The European Commission adopted new rules for assessing cooperation agreements between competitors that took effect on July 1, 2023. Canada recently adopted no-poaching and wage-fixing enforcement guidelines on the conduct that became criminal under Canadian law on June 23, 2023. The government of

the United Kingdom set out its expectations for the Competition and Markets Authority in a draft “strategic steer.” Meanwhile, in the U.S., a challenge to the retroactive application of the 2022 Venue Act failed, and the antitrust agencies published a summary of a workshop related to merger review and enforcement in the pharmaceutical industry.

Artificial Intelligence

[*Artificial Intelligence: Key Business and Legal Issues to Consider*](#) (September 19, 2023). The rapid growth of AI development and adoption, particularly generative AI and machine learning applications, has captured the attention of business leaders, academics, investors, and regulators worldwide. AI is also requiring companies to confront an evolving host of questions across different areas of law, including privacy, cybersecurity, commercial and intellectual property transactions, intellectual property ownership and rights, products liability, labor and employment, insurance, consumer protection, corporate governance, national security, ethics, government policy, and regulation. This resource outlines questions that companies and their boards should consider as they navigate this ever-evolving technological innovation. Many of these questions are industry-agnostic, but all companies must also address challenges specific to the industry and regulatory environment in which they operate. Sidley has a multi-disciplinary AI industry team focused on providing our clients with practical and actionable guidance on the wide range of regulatory, transactional, and litigation issues companies face in evaluating, leveraging, and mitigating risk from AI.

CFIUS; Foreign Investment

[*New Executive Order on Outbound Investment: What It Covers and What It Will Mean for Your Business*](#) (August 14, 2023). President Joe Biden issued an executive order on August 9, 2023, directing the Department of the Treasury (Treasury) to promulgate regulations that prohibit, or require notification to Treasury, of certain U.S. investments into Chinese entities involved in the (1) semiconductor and microelectronics, (2) quantum information technology, and (3) artificial intelligence sectors. On August 14, Treasury published proposals for the new regulatory regime and has asked for public comment by September 28, 2023.

[*Top 10 Takeaways From the U.S. Treasury CY 2022 CFIUS Annual Report*](#) (August 9, 2023). On July 31, 2023, Treasury released its CY 2022 Committee on Foreign Investment in the United States (CFIUS) Annual Report to Congress. Sidley’s CFIUS team breaks down the report and provides insights on the implications of the data.

Corporate Governance and SEC Disclosure

[*Timely Takes Podcast: Earnings Pre-Releases*](#). Sidley partners Beth Berg, Paul Choi, and Jim Ducayet join John Jenkins, managing editor of TheCorporateCounsel.net, to discuss various issues surrounding a decision to release earnings earlier than scheduled, including the legal, investor relations, and practical considerations that should be considered in making such a decision.

ESG

[*EU Adopts First Set of European Sustainability Reporting Standards—Critical Considerations for Companies in Scope of CSRD*](#) (August 30, 2023). The European Commission’s recent adoption of European Sustainability Reporting Standards (ESRS) under the Corporate Sustainability Reporting Directive (CSRD) marks a significant development for in-scope companies. As the ESRS become a fixture in sustainability reporting from January 2024, companies face a critical time for compliance and alignment with the new standards.

Regulatory

[*PCAOB Closes Comment Period on Proposal to Expand Auditor Responsibility for Considering Noncompliance With Laws and Regulations*](#) (August 31, 2023). The Public

Company Accounting Oversight Board (PCAOB) has closed the comment period for its proposal to amend the professional auditing standards that govern the auditor's consideration of a company's noncompliance with laws and regulations. If adopted, the proposed rule would significantly expand the auditor's objectives and responsibilities when auditing the financial statements of public companies and increase the role of specialists (including outside legal counsel) in the performance of financial statement audits. The amendments would also (1) expand the role of in-house legal and compliance departments in financial statement audits, (2) have significant implications with regard to the protection of confidential information otherwise subject to the attorney-client privilege, and (3) increase the scope and frequency of communications between auditors and public company audit committees.

Shareholder Activism

[*How to Deal With Shareholder Activists: An Open Letter to Corporate CEOs and Founders*](#) (July 24, 2023). Over the past decade, shareholder activism has become a permanent part of the landscape for public companies. Last year, Silicon Valley was a particular hotbed of shareholder activism, and activists haven't let up with their focus on tech companies in 2023. Conditions have been ripe: valuation multiples have compressed in many subsectors as investors have quickly shifted demands from "growth" to "profitable growth." In this *Silicon Valley Business Journal* article, Derek Zaba, co-head of Sidley's global shareholder activism practice, offers advice to public company CEOs and founders about how to deal with shareholder activists.

SIDLEY SPEAKERS

Northwestern Pritzker School of Law 2023 Garrett Institute

October 5-6, 2023 | Chicago

Northwestern Pritzker School of Law will host its 43rd annual Ray Garrett Jr. Corporate & Securities Law Institute in Chicago on October 5-6. The Garrett Institute is designed to provide private practitioners and corporate counsel with a timely analysis of current securities and corporate law developments confronting publicly and privately held corporations. On October 5, Brian Fahrney, global co-leader of Sidley's M&A and Private Equity group, will chair a session titled *Just a Little Healthy Competition—Regulatory Trends Affecting M&A*. Click [here](#) for more information.

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