April 15, 2024

Q1 2024 U.S. Legal & Regulatory Developments

The following is our summary of significant U.S. legal and regulatory developments during the first quarter of 2024 of interest to Canadian companies and their advisors.

1. SEC Adopts and Subsequently Stays New Climate Disclosure Requirements

On March 6, 2024, the United States Securities and Exchange Commission (the "SEC") adopted significant new climate-related disclosure requirements, marking the first U.S. federal regime of its kind. The finalization of these rules comes almost two years after the SEC proposed them, and after an intense comment process.

The SEC's Stay

On April 4, 2024, the SEC issued an order staying the new rules pending the outcome of litigation in the U.S. Court of Appeals for the Eighth Circuit. The rules are the subject of numerous legal challenges, initially leading to a stay issued by the U.S. Court of Appeals for the Fifth Circuit, but all of which have now been consolidated into one litigation in the Eighth Circuit. In its order, the SEC noted that "the Commission is not departing from its view that the [climate-related disclosure requirements] are consistent with applicable law and within the Commission's long-standing authority to require the disclosure of information important to investors in making investment and voting decisions" and that it would continue to vigorously defend the new rules in court. However, the SEC decided to voluntarily stay the rules to facilitate the orderly resolution of these challenges and to avoid companies being subject to the rules during the pendency of the litigation. It is currently unclear how the stay might affect the compliance deadlines for the new requirements.

Summary of Disclosure Requirements

In a notable, though not unexpected, departure from the proposal, the final rules eliminate the controversial requirement to disclose Scope 3 greenhouse gas ("GHG") emissions. The SEC also limited the requirement to disclose Scope 1 and Scope 2 GHG emissions: only large accelerated filers and accelerated filers will be required to disclose them (and eventually provide attestation reports), and only if they are material (to the filer). The SEC also modified its proposal to disclose certain climate-related financial statement metrics and related disclosures in a note to audited financial statements; the new rules will instead require disclosure in notes to the financial statements of the costs, expenses and losses associated with severe weather events and carbon offsets and renewable energy credits or certificates (if a material component of any climate target or goal).

These new requirements would apply to domestic registrants as well as foreign private issuers ("FPIs") filing on Form 20-F. However, these requirements would not apply to multijurisdictional disclosure system issuers filing on Form 40-F. The final rules have a multi-year phase-in for the disclosure requirements, based on company filing status, as noted below.

As proposed, these new requirements are modeled in part on the Task Force on Climate-Related Financial Disclosures and the Greenhouse Gas Protocol emissions reporting frameworks. The new disclosure requirements will be set forth in a new Item 1500 of Regulation S-K and Article 14 of Regulation S-X. Registrants would be required to present in their annual reports (or registration statements) and in the accompanying financial statements, detailed information regarding, among others, the following:

- material climate-related risks, their actual and potential material impacts on strategy, business model and outlook, and any mitigation or adaptation activities;
- material climate-related targets or goals and any transition plans;
- costs, expenses, charges and losses associated with severe weather events (subject to a 1% and de minimis disclosure thresholds), and relating to carbon offsets and renewable energy credits of certificates if material to targets or goals;
- company board and management oversight and governance of climate-related risks; and
- for large accelerated filers and accelerated filers, Scope 1 and Scope 2 GHG emissions data, if material, and eventually third party attestations providing assurance on the GHG emissions data.

These disclosure requirements would be phased in, depending on the registrant's filing status:

	Climate-Related Disclosures under S-K and S-X (other than those noted in this table)	**Disclosure of Material Expenditures and Impacts from mitigation or adaptation activities, transition plan activities and actions taken to achieve a target or goal**	**Scope 1 and Scope 2 GHG Emissions***	**Limited Assurance on Disclosure of GHG Emissions**	**Reasonable Assurance on Disclosure of GHG Emissions**
Large Accelerated Filers	For the report covering the fiscal year beginning in ("FYB") 2025; to be filed in 2026	FYB 2026; to be filed in 2027	FYB 2026; to be filed in 2027	FYB 2029; to be filed in 2030	FYB 2033; to be filed in 2034
Accelerated Filers	FYB 2026; to be filed in 2027	FYB 2027; to be filed in 2028	FYB 2028; to be filed in 2029	FYB 2031; to be filed in 2032	N/A
Non-Accelerated Filers, Smaller Reporting Companies & Emerging Growth Companies	FYB 2027; to be filed in 2028	FYB 2028; to be filed in 2029	N/A	N/A	N/A

* *The Scope 1 and Scope 2 emissions may be filed in the quarterly report on Form 10-Q for the second fiscal quarter in the fiscal year following the year for which reporting is required or, for an FPI, in an amendment to its annual report on Form 20-F, due no later than 225 days after the end of the year for which reporting is required.*

Large multinational companies with significant operations and sales in the European Union and companies with significant operations in or sales to California may have separate obligations to report Scope 3 emissions and other climate change-related information to other jurisdictions; these new SEC requirements will not affect those reporting obligations.

For the full text of our memorandum on the new rules, please see:

- https://www.paulweiss.com/media/3984463/sec_adopts_new_climate_disclosure_requirements.pdf

For the SEC's final rules, please see:

- https://www.sec.gov/files/rules/final/2024/33-11275.pdf

For the full text of our memorandum on the SEC's order issuing a stay of the new rules, please see:

- https://www.paulweiss.com/media/3984576/sec_stays_its_climate_disclosure_requirements.pdf

For the SEC's order issuing a stay of the new rules, please see:

- https://www.sec.gov/files/rules/other/2024/33-11280.pdf

2. Delaware Court of Chancery Holds That Activision Merger Approval Process Violated DGCL

In *Sjunde AP-fonden* v. *Activision Blizzard, Inc., et al.* ("*Activision*") (an opinion by Chancellor Kathaleen St. J. McCormick), the Delaware Court of Chancery declined to dismiss claims that common market practices used by the Activision Blizzard, Inc. ("Activision") board in approving its merger agreement with Microsoft Corporation ("Microsoft") resulted in a Delaware General Corporation Law ("DGCL") violation. The opinion interprets the current statutory requirements strictly, invalidating established market practice, which at least in the short term will result in disruption to deal parties and practitioners.

A legislative fix has been approved by the Council of the Corporation Law Section of the Delaware State Bar Association ("DSBA") (the body that annually proposes DGCL amendments to the full DSBA and, ultimately, the Delaware General Assembly). However, this is a preliminary step and there is no assurance that the proposed amendments will be adopted in their current form. If enacted as proposed, the amendments would be effective August 1, 2024, and apply retroactively to agreements and other documents approved or entered into previously. While civil actions or proceedings completed or pending before August 1, 2024 would still be permitted to stand, they are likely to have less impact if the amendments are adopted.

As we wait for finalization of these amendments or further clarification or appeal of *Activision*, parties to merger agreements would still be well served to have final "clean up" board meetings (or actions by unanimous written consent) after they send the directors a complete merger agreement with all schedules and exhibits, including the surviving corporation charter, attached and all blanks (including real names rather than code names for the parties and the cash value or exchange ratio) filled in.

Background

In December 2021, Activision agreed to be acquired by Microsoft at a price of $95 per share. In January 2022, the Activision board met and approved a then-current draft of the merger agreement. The approved draft merger agreement did not yet include, as is often the case: (i) the company disclosure letter or disclosure schedules; (ii) the surviving company's charter; or (iii) the consideration amount and Activision's name as the target, instead including placeholders for both (which are typically added only just before signing and announcement in order to maximize confidentiality). The merger agreement also failed to address the "key open issue" of dividends that Activision could pay while the deal was awaiting regulatory approval. The board delegated this issue to a board committee, which ultimately negotiated a resolution. The full board did not review or approve any subsequent version of the merger agreement. The proxy statement sent to Activision stockholders attached the merger agreement without the disclosure letter, disclosure schedules or the surviving company's charter. In April 2022, Activision stockholders approved the merger, with more than 98% voting in favor of it.

In November 2022, the plaintiff filed suit in the Court of Chancery, alleging that the merger agreement approval process violated Sections 251 and 141 of the DGCL, as well as various other related claims. In January 2023, the plaintiff added allegations concerning regulatory developments relating to the merger, as well as a count for breach of fiduciary duty based on speculation that the defendants had agreed to extend the merger's outside termination date. Activision did later agree to extend the outside termination date, but not until six months after the plaintiff filed the amended complaint. Ultimately, the merger cleared regulatory hurdles and closed in October 2023.

Holding

The court declined to grant the defendants' motion to dismiss with respect to certain of the claims as follows:

- <u>Section 251(b) Violation</u>. This section requires the board to approve the "agreement of merger" when the corporation desires to engage in a merger transaction. The plaintiff argued that the board must approve the final execution version of the merger agreement, while defendants argued that this interpretation of Section 251(b) is not required by the language, would be contrary to market practice and would create uncertainty about the validity of a very large number of Delaware corporation mergers. The court acknowledged that requiring board approval of the execution version "does not square with norms of market practice" (e.g., disclosure schedules are often negotiated up until signing or sometimes delivered after signing), but added that "[w]here market practice exceeds the generous bounds of private ordering afforded by the DGCL, then market practice needs to check itself." Ultimately, the court assumed "for the sake of analysis . . . that Section 251(b) does not require board approval of the execution version of a merger agreement" but, at a bare minimum, does require "a board to approve an essentially complete version of the merger agreement." Applying that standard, the court found that plaintiff's claim survived the motion to dismiss.

- Section 251(c) Violation. This section requires a notice of the stockholder meeting set for the purpose of acting on the merger agreement to contain either (i) the merger agreement or (ii) a brief summary thereof. Here, defendants chose to attach the merger agreement to the notice. However, the attached agreement omitted a copy of the surviving company's charter, which is required by statute, and therefore, the plaintiff's claim survived the motion to dismiss. The fact that the defendants summarized the merger agreement in the proxy statement was of no consequence according to the court because the summary was not in the notice itself, as required by the statute, even though both the notice and the merger agreement summary were part of the same document – the proxy statement.

- Section 141(c) Violation. This section prohibits delegating to a board committee any power or authority that is specifically reserved for the board, including the adoption of an agreement of merger under Section 251. In this case, the Activision board delegated to a committee the open issue of the dividends that Activision could pay while awaiting regulatory approval of the deal. The court stated that because this was a merger agreement provision that in its view must be approved by the board, such committee delegation was a statutory violation, and the plaintiff's claim survived the motion to dismiss.

- Conversion Claims. A claim for the tort of "conversion" requires that, at the relevant time, (i) the plaintiff held a property interest in company stock, (ii) the plaintiff had a right to possession of the stock, and (iii) the defendant converted the plaintiff's stock. In the context of pleading the tort, a defendant "converts" the plaintiff's stock through "any act of control or dominion . . . without the [plaintiff's] authority or consent, and in disregard, violation, or denial of [the plaintiff's] rights as a stockholder of the company." Here, the plaintiff's shares were converted (in the sense relating to his receipt of merger consideration) into the right to receive cash in the merger. The court stated that "[t]hrough the merger, [d]efendants took [p]laintiff's shares and replaced them with something else, in disregard of his rights as a stockholder under Section 251." Because, according to the court, the plaintiff adequately alleged that the merger was invalid under Section 251, its conversion claim survived the motion to dismiss.

The Proposed DGCL Amendments

As noted, the Council of the Corporation Law Section of the DSBA has approved amendments to the DGCL that would address many of *Activision*'s holdings. If ultimately enacted, the DGCL amendments would, in summary and subject to certain procedures and conditions: (i) permit the board to approve or take action required by the DGCL with respect to documents that are in substantially final or final form, (ii) permit the board to ratify previously approved documents before the effectiveness of any required filing with the Delaware Secretary of State that references or includes such document, (iii) clarify that stockholder notices are deemed to include any document enclosed with or attached or annexed to the notice (such as a merger agreement attachment to the proxy statement with such a stockholder notice), (iv) clarify that in certain circumstances the certificate of incorporation of the surviving company need not be attached to the merger agreement for the agreement to be considered final or substantially final and (v) clarify that disclosure letters and schedules are not deemed a part of a merger agreement unless expressly so provided.

For the full text of our memorandum, please see:

- https://www.paulweiss.com/media/3984589/delaware_court_of_chancery_holds_that_activision_merger_approval_process_violated_dgcl.pdf

For the Delaware Court of Chancery's opinion in *Activision*, please see:

- https://courts.delaware.gov/Opinions/Download.aspx?id=361510

3. SEC Approves Amendment to NYSE Shareholder Approval Requirements

On December 26, 2023, the SEC approved an amendment to the shareholder approval requirements of the New York Stock Exchange (the "NYSE") in the case of certain issuances to a substantial security holder. Under amended Section 312.03(b)(i) of the NYSE Listed Company Manual, listed companies will no longer be required to get shareholder approval for issuances to substantial security holders in excess of 1% which are below the "Minimum Price" where such substantial security holders are not "Active Related Parties" – i.e., controlling stockholders or members of a control group or have an affiliated person serving as an officer or director of the listed company. For purposes of Section 312.03(b)(i) of the NYSE Listed Company Manual, "control" has the same meaning as defined in Rule 12b-2 of Regulation 12B under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), and "group" means a group as determined in accordance with Section 13(d)(3) or Section 13(g)(3) of the Exchange Act. The "Minimum Price" is defined in Section 312.04(h) of the NYSE Listed Company Manual as the lower of (i) the official closing price on the NYSE as reported to the Consolidated Tape (the "Official Closing Price") immediately preceding the signing of the binding agreement; or (ii) the average Official Closing Price for the five trading days immediately preceding the signing of the binding agreement.

Issuances to substantial security holders (regardless of whether they are Active Related Parties or not) remain subject to other NYSE shareholder approval requirements, including Section 312.03(c) of the NYSE Listed Company Manual, which requires shareholder approval for issuances in excess of 20% of the outstanding at a price below the Minimum Price, and Section 312.03(b)(ii), which requires shareholder approval for issuances to substantial security holders (regardless of their control status or affiliated directors or officers), where such securities are issued as consideration in a transaction or series of related transactions in which such substantial security holder (or a director or officer) has a 5% or greater interest (or such persons collectively have a 10% or greater interest), directly or indirectly, in the company or assets to be acquired or in the consideration to be paid in the transaction or series of related transactions and the present or potential issuance of common stock, or securities convertible into common stock, could result in an issuance that exceeds either 5% of the number of shares of common stock or 5% of the voting power outstanding before the issuance.

In proposing this amendment, the NYSE noted that issuances to substantial security holders that are not Active Related Parties do not pose the same potential conflicts of interest as issuances to those shareholders who participate in the listed company's governance or management and have the ability to influence decision making. This amendment will more closely align the NYSE's shareholder approval requirements with those of Nasdaq and ease listed companies' ability to raise capital from existing shareholders.

For the full text of our memorandum, please see:

- https://www.paulweiss.com/media/3984188/sec_approves_amendment_to_nyse_shareholder_approval_requirements.pdf

For the full text of the amendment, please see:

- https://www.sec.gov/comments/sr-nyse-2023-34/srnyse202334-320179-832762.pdf

4. Delaware Courts Provide Guidance on Advance Notice Bylaws

Recent decisions by Vice Chancellor Will of the Delaware Court of Chancery in *Paragon Technologies, Inc.* v. *Cryan* ("*Paragon*") and *Kellner* v. *AIM Immunotech Inc.* ("*Kellner*") provide guidance for boards concerning the validity of advance notice bylaws. In both cases, the court upheld the boards' enforcement of advance notice bylaws to prevent activist nominees from standing for election. In *Kellner*, however, the court invalidated some bylaw provisions because of their overbreadth or ambiguity. The court found those bylaws to be unreasonable under an enhanced scrutiny standard the Delaware Supreme Court articulated last year. *Paragon* and *Kellner* reflect the Delaware courts' general approach to uphold reasonable and clear advance notice bylaws and to carefully scrutinize overly broad or vague bylaws. Below, we discuss key themes from these two decisions.

Takeaways from the Court's Decisions

Delaware courts will evaluate board decisions on advance notice bylaws under enhanced scrutiny review. Since 1988, boards acting with the "primary purpose" of interfering with the right to elect directors had to show a compelling justification for that action under the *Blasius* standard. Last year, in *Coster* v. *UIP Companies, Inc.*, the Delaware Supreme Court held that actions allegedly taken to interfere with the corporate franchise should be evaluated under the standard used to examine the adoption of defensive measures generally "with sensitivity to the stockholder franchise." Fundamentally, the standard is reasonableness and requires a two-part analysis: (i) whether the board faced a threat "to an important corporate interest or to the achievement of a significant corporate benefit" and (ii) "whether the board's response to the threat was reasonable in relation to the threat posed and was not preclusive or coercive to the stockholder franchise."

Reasonable, unambiguous advance notice bylaws will continue to be enforced by Delaware courts. Although courts have stated in the poison pill context that protecting against "activism" in and of itself is not a legitimate corporate interest, both *Kellner* and *Paragon* reiterate that there is a legitimate corporate interest for advance notice bylaws – namely, ensuring transparency from a nominating stockholder and its nominees so that boards have time to evaluate proposed candidates, stockholders are fully informed and elections are orderly. With these purposes in mind, courts must determine whether a board's decisions concerning an advance notice bylaw were reasonable in relation to the threat posed, including the reasonableness of the terms of the bylaw itself and of the board's enforcement of the bylaw against activists.

In *Kellner*, for example, the court deemed reasonable a 24-month lookback on a requirement to disclose all agreements, arrangements and understandings "whether written or oral, and including promises" relating to a director nomination because it clarified the period covered by the requirement and "reduced the risk of gamesmanship through overly narrow readings of the bylaw." The court also found that a provision requiring disclosure of the dates of first contact among those involved in the nomination, while unusual, was tailored and called for a "more defined set of information that could be known or knowable with reasonable diligence" and that a requirement that nominees complete a questionnaire in the form provided by the company was reasonable in scope. Similarly, in *Paragon*, the court found certain other advance notice bylaws to be reasonable, including one requiring plans or proposals that would be required to be disclosed pursuant to Item 4 of Schedule 13D, as well as one requiring the disclosure of potential conflicts and "substantial interests" pursuant to Regulation 14D.

Advance notice bylaws that are overly broad or difficult to decipher may fail enhanced scrutiny review. Boards adopting or amending advance notice bylaws should review the terms for clarity and overbreadth, ensuring that the provisions do not unduly burden a stockholder's ability to submit a compliant nomination. In *Paragon*, the court questioned the reasonableness of a requirement to disclose "events, occurrences, and/or circumstances involving or relating to the Proposed Nominee that could impact, impede, and/or delay" a candidate's ability to obtain security clearance. The court agreed with the plaintiff's position that the bylaw was ambiguous and that "stockholders are left to guess" about the impediments required to be disclosed. Similarly, in *Kellner*, the court found a number of advance notice bylaws to be overly broad or ambiguous, including:

- A definition of "Stockholder Associated Person" that created "an ill-defined web of disclosure requirements" with "unending permutations" ("Stockholder Associated Person" was defined in *Kellner* to be "any person acting in concert with [a] Holder [(i.e., the nominating stockholder and each beneficial owner on whose behalf the nomination is made)] with respect to the Stockholder Proposal or the Corporation, (ii) any person controlling, controlled by, or under common control with such Holder or any of their respective Affiliates or Associates, or a person acting in concert therewith with respect to the Stockholder Proposal or the Corporation, and (iii) any member of the immediate family of such Holder or an Affiliate or Associate of such Holder");

- A requirement to disclose agreements, arrangements and understandings between the nominating stockholder or a Stockholder Associated Person, on the one hand, and any stockholder nominee, on the other hand, regarding consulting, investment advice or a previous nomination for a publicly traded company within the last 10 years. While a similar requirement had been previously upheld by a Delaware court, the 10-year lookback in this provision was deemed too long;

- A requirement to disclose all known supporters of the nominating stockholder and nominees which was too broad and went beyond a similar provision previously validated by a Delaware court that was limited to "financial" supporters; and

- A requirement to disclose ownership of company stock (including beneficial, synthetic, derivative and short positions), which extended to Stockholder Associated Persons, immediate family members and persons acting in concert, which the court deemed "indecipherable" such that "[a] stockholder could not fairly be expected to comply."

A Delaware court will look at whether the board's enforcement of an otherwise valid advance notice bylaw is equitable. If a board's enforcement of a valid advance notice bylaw has a preclusive effect on a stockholder's ability to make nominations, then the court may require the board to permit the activist's nominees to stand for election. For example, in *Paragon*, aspects of the preliminary record caused the court to "look skeptically" at the board's response to the activist's nomination notice, including the fact that the board declined to provide a complete list of deficiencies and continually found new deficiencies. The court found some of these shortcomings identified by the board to be "nitpicky" or "suspect," including rejection of the notice for failure to comply with the bylaw requiring a nominee to disclose known barriers to obtaining a security clearance where none of the sitting directors had a security clearance and the board did not oversee matters involving classified information.

For the full text of our memorandum, please see:

- https://www.paulweiss.com/media/3984300/delaware_courts_provide_guidance_on_advance_notice_bylaws.pdf

For the Delaware Court of Chancery's opinion in *Paragon*, please see:

- https://courts.delaware.gov/Opinions/Download.aspx?id=356120

For the Delaware Court of Chancery's opinion in *Kellner*, please see:

- https://courts.delaware.gov/Opinions/Download.aspx?id=357400

5. Delaware Court of Chancery Rescinds Elon Musk's $55.8 Billion Tesla Compensation Plan

On January 30, 2024, in *Richard J. Tornetta et al.* v. *Elon Musk et al.* ("*Tornetta*"), the Delaware Court of Chancery (in an opinion by Chancellor McCormick) held that Tesla, Inc.'s ("Tesla's") board of directors had breached its fiduciary duties by awarding CEO Elon Musk an incentive-based compensation package that was ultimately valued at $55.8 billion (the "Compensation Package"). The court found that Musk and Tesla's board failed to prove the Compensation Package was "entirely fair" under Delaware law, and ordered that the Compensation Package be rescinded entirely.

Background

The Compensation Package afforded Musk the opportunity to receive up to 12 total tranches of options, with each tranche representing 1% of Tesla's outstanding shares as of January 2018, if Tesla achieved certain market capitalization, EBITDA and revenue-based targets. By June 2022, nearly all targets had been achieved.

Tesla's board of directors approved the Compensation Package on January 21, 2018 and a majority of Tesla's disinterested stockholders subsequently approved the Compensation Package at a special meeting. In June 2018, the plaintiff, a stockholder of Tesla, filed a complaint alleging that both Musk and Tesla's board had breached their respective fiduciary duties in awarding the Compensation Package.

Court's Reasoning

Though Musk owned only 21.9% of Tesla's common stock at the time Telsa's board approved the Compensation Package, the court nevertheless found that he had transaction-specific control. While Musk lacked "mathematical voting control," the court examined other factors including Musk's "unusually expansive managerial authority," his extensive business and personal relationships with several members of Tesla's board and his personal involvement and control over the process through which the Compensation Package had been awarded. The court held that the "entire fairness" standard of review, Delaware's most stringent form of judicial review, should apply to the Compensation Package because Musk was a controller and the board's decision to grant the Compensation Package was a conflicted-controller transaction.

Additionally, the court held that the defendants bore the burden of proof to demonstrate the Compensation Package was entirely fair. Under Delaware law, defendants may shift the burden of proof to the plaintiff by showing that the transaction was approved by an informed vote of a majority of the minority stockholders. Although the Compensation Package achieved majority-of-the-minority approval at the special meeting, the court found that Tesla's stockholders were not fully informed. Specifically, the court found that the special meeting proxy statement failed to disclose both Musk's relationship with compensation committee members and Musk's involvement and control over the process of awarding the Compensation Package.

In the court's view, the defendants failed to meet the burden of proving that the Compensation Package was entirely fair, both in process and in substance. On process, the court emphasized the conflicts between Tesla's board and Musk, and the absence of any true negotiations regarding the size, terms and timing of the Compensation Package. On substance, the court characterized the $55.8 billion award as "the largest potential compensation opportunity ever observed in public markets by multiple orders of magnitude," found that the performance conditions were neither ambitious nor difficult to achieve and rejected the defendants' arguments that the Compensation Package was necessary to incentivize and retain Musk. The court noted in particular that Musk was already strongly incentivized to grow Tesla's market capitalization through his 21.9% interest in the company and that Musk "was a lifer who intended to stay at Tesla" and "was not going anywhere," even if the board refused to grant the Compensation Package.

Takeaways
Tornetta provides a few helpful takeaways and reminders for companies to consider when making executive compensation awards.

- *Minority stockholders may be considered "controllers."* Delaware courts will apply a high standard of entire fairness where a controller is involved. Courts may find that minority stockholders with control of over 20% of a company's voting rights are controllers based on factors such as the stockholder's authority and importance to the company, as well as transaction-specific considerations such as the stockholder's involvement in the process.

- *A majority-of-the-minority stockholder vote is not enough if the stockholders are not fully informed.* While receiving majority-of-the-minority approval of executive compensation may help shield boards from scrutiny over their decisions, the benefits of such approval may be lost if disclosure to stockholders is inaccurate or omits material information. Disclosure of a compensation plan's economic terms alone may not be sufficient to make a stockholder vote informed.

- *Be mindful of director independence.* Despite compliance with independence standards under stock exchange rules or securities laws, courts may still find conflicts of interest when scrutinizing executive compensation committee decisions. Courts may consider close personal and business ties between an executive and a director in making such determinations.

- *Boards should undertake and document thorough processes for approving executive compensation plans.* Key to the court's decision in *Tornetta* was the deficient process undertaken by the compensation committee. Boards and compensation committees should conduct a thorough, arm's length process when approving executive compensation plans, which may include benchmarking exercises. Boards and compensation committees should also be mindful of documenting the process involved in such decisions.

For the Delaware Court of Chancery's opinion in *Tornetta*, please see:

- https://courts.delaware.gov/Opinions/Download.aspx?id=359340

6. SEC Adopts New SPAC Rules

The SEC has adopted new rules regarding special purpose acquisition company ("SPAC") and de-SPAC transactions. While the SEC did not ultimately adopt some of its proposed rules and safe harbors, the rules it did adopt and the guidance it chose to issue will substantially alter the SPAC and de-SPAC landscape. Fundamentally, these rules will treat de-SPAC transactions more like traditional initial public offerings ("IPOs") – extending (via guidance) statutory underwriter liability on participants in de-SPAC transactions, making the target company in a de-SPAC transaction a co-registrant and eliminating the availability of the safe harbor of the Private Securities Litigation Reform Act of 1995 ("PSLRA") for projections included in de-SPAC registration statements. Rather than adopting the safe harbor that it initially proposed, the SEC issued guidance regarding the circumstances that could cause SPACs to be investment companies. In addition, the new rules expand the statutory disclosure requirements for SPAC and de-SPAC transactions, mandate a minimum dissemination period for security holder communication materials in de-SPAC transactions, and require a re-determination of smaller reporting company status following consummation of a de-SPAC transaction. Taken together, the new rules effectuate promises by senior SEC officials to more closely scrutinize, and exercise stricter oversight over the SPAC market. The rules will become effective July 1, 2024, while compliance with the structured data requirements will be required by June 30, 2025.

De-SPAC Transaction Underwriter Liability: The SEC did not adopt proposed Rule 140A, which would have deemed any SPAC IPO underwriter who facilitates the de-SPAC transaction or related financing, or otherwise participates in the de-SPAC transaction, to be an underwriter in the distribution of securities that is the de-SPAC transaction. Instead, the SEC issued guidance that:

- A de-SPAC transaction is a distribution of securities (the SEC noted its adoption of Rule 145a, which deems there to be a sale from the combined company to the SPAC's existing shareholders even in de-SPAC transaction structures where the target company is not "selling" or "distributing" its own securities into the market); and
- Participants in a de-SPAC distribution may be statutory underwriters where they are selling for the issuer or participating in the distribution of securities in the combined company to the SPAC's investors and the broader public.

De-SPAC Co-Registrants: As was proposed, the final rules amend Forms S-4 and F-4 to require that both the SPAC and the target company be treated as co-registrants. As a result, the target company, its principal executive officer, its principal financial officer, its controller/principal accounting officer, and a majority of its board of directors will be required to sign the registration statement and be subject to liability for any material misstatements or omissions in the registration statement.

In addition, the final rules:

- Require that the names of all co-registrants appear on the cover page;
- Clarify that the target company is a registrant (and not merely a signatory to the registration statement);
- Where the target consists of a business or assets, deem the seller of the business or assets to be a registrant (and require the seller to sign the registration statement); and
- Make conforming amendments to Form S-1 and Form F-1.

Projections: As proposed, the final rules eliminate the availability to SPACs and other blank check companies of the PSLRA safe harbor with respect to forward-looking statements. As a result, de-SPAC transactions will be treated like traditional IPOs (where the PSLRA safe harbor is also not available). To improve the presentation of projections, the SEC has also adopted additional disclosure requirements for projections via amendments to Item 10(b) of Regulation S-K (which would be applicable to all registrants, not just SPACs, and codify the SEC's guidance by giving greater prominence to projections based on historical results and require additional disclosures for any non-GAAP measures used in the projections) and new Item 1609 of Regulation S-K (which will only apply to de-SPAC transactions, and would require specific disclosures about the preparation of projections (who prepared them and for what purpose), the material bases and assumptions underlying the projections, and whether they still reflect the view of the board and management).

Enhanced Disclosures by Both the Target and SPAC

- *Target Disclosures*. To better synchronize de-SPAC and traditional IPO disclosures, the final rules, as initially proposed, (i) require certain non-financial Regulation S-K disclosures of targets in de-SPAC business combination filings, instead of in the post-closing "Super 8-K," so that SPAC investors will be able to review and consider the disclosure prior to making any voting or investment decision, and, to the extent that information is included in a registration statement, subject such information to liability under the Securities Act of 1933, as amended, and (ii) codify existing SEC guidance regarding financial statements in business combinations involving shell companies in a new Article 15 of Regulation S-X.

- *SPAC Disclosures*. The final rules create a new Subpart 1600 of Regulation S-K, setting forth specific SPAC disclosure requirements for SPAC IPOs (largely as proposed, including regarding SPAC sponsors, conflicts of interest and dilution, largely codifying and amplifying existing SEC guidance) and de-SPAC transactions. Notably, the SEC moved away from its proposal to require a statement about the fairness of the de-SPAC transaction and related financing. Instead, if the law of the jurisdiction of the SPAC's organization requires the SPAC's board of directors to determine whether the de-SPAC transaction is advisable and in the best interests of the SPAC and its shareholders, the SPAC will be required to disclose that determination. In making that determination, the following factors should be considered (though it is not an inclusive list): the valuation of the target company, financial projections relied upon by the board, the terms of financing materially related to the de-SPAC transaction, any report, opinion, or appraisal and the dilutive effect of the de-SPAC transaction and related financing.

Smaller-Reporting Company Status: Post de-SPAC companies will be required to re-evaluate their smaller-reporting company status prior to the time they make their first post de-SPAC SEC filing (other than the Super 8-K), measuring the public float as of a date within four business days of the consummation of a de-SPAC transaction.

Investment Company Act: The SEC did not adopt its proposed Investment Company Act of 1940 ("Investment Company Act") safe harbor for SPACs. Instead, the SEC issued the following guidance regarding the facts and circumstances SPACs should consider in evaluating their status as investment companies:

- *The nature of SPAC assets and income*. The types of assets held by a SPAC will impact its analysis as an investment company. Investments by a SPAC in corporate bonds, or in minority interests with a view to passive investment, would affect the analysis of whether a SPAC is an investment company. The SEC specifically noted that a SPAC that owns or proposes to acquire 40% or more of its total assets in investment securities would likely need to register under the Investment Company Act unless an exclusion applies. The SEC also noted that such activities would also weigh in favor of a SPAC being considered to be primarily engaged in the business of investing, reinvesting, and trading in securities. In addition, a SPAC whose income is substantially derived from such assets would further suggest that the SPAC is an investment company. A SPAC that holds only the sort of securities typically held by SPACs, such as U.S. Government securities, money market funds and cash items prior to the completion of the de-SPAC transaction, and does not propose to acquire investment securities, would be more likely *not* to be considered an investment company; however, an issuer that holds these assets, but whose primary business is to achieve investment returns on such assets would still be considered an investment company.

- *Management activities*. The SEC noted that it would have serious concerns if a SPAC held its investors' money in securities, but the SPAC's officers, directors and employees did not actively seek a de-SPAC transaction or spent a considerable amount of time actively managing the SPAC's portfolio for the primary purpose of achieving investment returns. Further, depending on the facts and circumstances, the management of a SPAC also could cause SPAC sponsors to come within the definition of "investment adviser" in Section 202(a)(11) of the Investment Advisers Act of 1940.

- *Duration*. The longer a SPAC takes to achieve its stated business purposes, the more difficult it will be to distinguish a SPAC's activities from those of an investment company. Accordingly, SPACs that operate without entering an agreement for a de-SPAC transaction within 12 to 18 months raise concerns that they may be investment companies. These concerns increase as the departure from these timelines lengthens.

- *How the SPAC presents itself to investors*. A SPAC positioning itself as (or "holding itself out as") an opportunity for investors to primarily invest in its securities for exposure to its portfolio prior to the de-SPAC transaction is likely to meet the definition of an investment company. Marketing as a fixed-income alternative suggests an active engagement in the business of investing, reinvesting or trading in securities.

- *Merging with an investment company*. If a SPAC were to engage or propose to engage in a de-SPAC transaction with a target company that meets the definition of an investment company, such as a closed-end fund or a business development company, the SPAC is likely to be an investment company.

For the full text of our memorandum, please see:

- https://www.paulweiss.com/media/3984314/sec_adopts_new_spac_rules.pdf

For the SEC's final rules, please see:

- https://www.sec.gov/files/rules/final/2024/33-11265.pdf

7. Delaware Court of Chancery Holds That Controllers May Owe Fiduciary Duties When Exercising Stockholder Rights

In *In re Sears Hometown and Outlet Stores, Inc. Stockholder Litigation* ("*Sears*"), the Delaware Court of Chancery (in an opinion by Vice Chancellor J. Travis Laster) clarified that, when exercising stockholder rights to alter a corporation's status quo, controllers owe duties not to harm the corporation or its minority stockholders intentionally or through gross negligence. If a controller acts as a stockholder to impair the rights of directors or the minority stockholders, the court will apply enhanced scrutiny review, requiring the controller to show that he or she acted in good faith for a legitimate objective, had a reasonable basis for believing that action was necessary and selected a reasonable means for achieving the legitimate objective. Prior to this, it had been clear that controlling stockholders owe fiduciary duties when using their influence over the board and management to cause the corporation to act, but there were competing lines of authority regarding whether any duties were owed when controllers act solely as stockholders. Analyzing this open question, the *Sears* decision, which remains subject to appeal to the Delaware Supreme Court, held that controllers are subject to fiduciary constraints when exercising their stockholder rights to alter a corporation's status quo but reiterated that controllers do not owe fiduciary duties when they exercise the right to vote or sell stock to defend themselves from corporate actions and preserve the status quo. The decision further clarified that, unlike fiduciary duties owed by directors, controlling stockholders may continue to act in their own self-interest as opposed to promoting the best interests of the corporation, so long as they do not act intentionally or with gross negligence to harm the corporation or minority stockholders.

Sears Hometown & Outlet Stores (the "Company") had two businesses, Hometown Stores and Outlet Stores, and was controlled by Eddie Lampert. Hometown Stores ran into severe financial difficulties, and the Company formed a special committee that was initially authorized only to explore possible transactions with Lampert, but later was also authorized to explore any bankruptcy-related transaction. Management and the special committee began to believe that a Hometown liquidation was the best option unless an appropriately priced deal could be reached with Lampert. But Lampert believed in earnest that liquidation would destroy value because of the overly optimistic expectations of management and the special committee on the liquidation proceeds. When the special committee and Lampert could not reach agreement on price, and liquidation looked imminent, Lampert acted by written consent to thwart it by (i) amending the Company's bylaws so that a liquidation of the Hometown business would require 90% approval by the board of directors in two votes at least 30 business days apart (with interim disclosure of the initial vote to stockholders) and (ii) removing two special committee directors who had most vocally supported the liquidation plan. The Court of Chancery decision referred to these actions as the "Controller Intervention."

With only one remaining member, the special committee decided that the only viable way forward was to continue negotiations for a sale of the Hometown business or the entire Company. Lampert agreed to buy the Company, minus Outlet Stores, for $2.25 per share. He further agreed that Outlet Stores would be sold during an 84-day go-shop period, subject to a floor price and a matching right held by Lampert. During the go-shop, a third party purchased Outlet Stores for $121 million, $1 million over Lampert's matching right. Stockholders received $2.25 per share from Lampert for everything but Outlet Stores, and $0.96

per share from the purchaser of Outlet Stores, collectively a 76% premium over the Company's trading price. Stockholders challenged the transaction.

For the full text of our memorandum, please see:

- https://www.paulweiss.com/media/3984348/delaware_court_of_chancery_holds_that_controllers_may_owe_fiduciary_duties_when_exercising_stockholder_rights.pdf

For the Delaware Court of Chancery's opinion in *Sears*, please see:

- https://courts.delaware.gov/Opinions/Download.aspx?id=358990

8. Hart-Scott-Rodino and Clayton Act Section 8 Thresholds for 2024

The Federal Trade Commission (the "FTC") has revised the jurisdictional and filing fee thresholds of the Hart-Scott-Rodino Antitrust Improvements Act of 1976 (the "HSR Act") and the Premerger Notification Rules based on changes in the gross national product ("GNP") as required by the 2000 amendments to the HSR Act. The filing thresholds and fees will increase as a result of the increase in the GNP and will apply to transactions that close on or after March 6, 2024. These threshold and filing fee adjustments occur annually and do not alter the current HSR Act filing process.

The HSR Act requires parties intending to merge or to acquire assets, voting securities or certain non-corporate interests to notify the FTC and the Antitrust Division of the Department of Justice and to observe certain waiting periods before consummating the acquisition. Notification and Report Forms must be submitted by the parties to a transaction if both the (1) size of transaction and (2) size of parties thresholds are met, unless an exemption applies.

1. Size of Transaction

The minimum size of transaction threshold, effective as of March 6, 2024, is $119.5 million. This is an increase from the 2023 threshold of $111.4 million.

2. Size of Parties

The size of parties threshold is inapplicable if the value of the transaction exceeds $478 million ($445.5 million in 2023). For transactions with a value between $119.5 million and $478 million, the size of parties threshold must be met and will be satisfied in one of the following three ways:

	I	II	III
Acquiring Person:	$239 million annual net sales or total assets	$239 million annual net sales or total assets	$23.9 million annual net sales or total assets
	and	and	and
Acquired Person:	$23.9 million total assets	a manufacturer with $23.9 million annual net sales or total assets	$239 million annual net sales or total assets

The various jurisdictional thresholds, notification thresholds, filing fee thresholds and thresholds applicable to certain exemptions will also increase, as summarized in Appendix A in the full text of this memorandum.

3. Filing Fees

On December 29, 2022, the President signed into law H.R. 2617, the Consolidated Appropriations Act, 2023, which included the Merger Filing Fee Modernization Act. This Act required the FTC to revise the filing fees and the filing fee thresholds annually. For all filings made on or after March 6, 2024, the new HSR Act filing fees will be as follows:

2024 Adjusted Filing Fee	Size of Transaction
$30,000	More than $119.5 million, but less than $173.3 million
$105,000	not less than $173.3 million, but less than $536.5 million
$260,000	not less than $536.5 million, but less than $1.073 billion
$415,000	not less than $1.073 billion, but less than $2.146 billion
$830,000	not less than $2.146 billion, but less than $5.365 billion
$2,335,000	$5.365 billion or more

The above thresholds and fees will continue to adjust annually.

The FTC also announced the maximum civil penalty for HSR Act violations, raising the amount from $50,120 per day to $51,744 per day, effective as of January 10, 2024.

Finally, the FTC has increased, effective January 22, 2024, the thresholds that prohibit, with certain exceptions, competitor companies from having interlocking relationships among their directors or officers under Section 8 of the Clayton Antitrust Act of 1914 (the "Clayton Act"). Section 8 provides that no person shall, at the same time, serve as a director or officer in any two corporations that are competitors, such that elimination of competition by agreement between them would constitute a violation of the antitrust laws. There are several "safe harbors" which render the prohibition inapplicable under certain circumstances, such as when the size of the corporations, or the size and degree of competitive sales between them, are below certain dollar thresholds. Competitor corporations are now subject to Section 8 of the Clayton Act if each one has capital, surplus and undivided profits aggregating more than $48,559,000, although no corporation is covered if the competitive sales of either corporation are less than $4,855,900. Even when the dollar thresholds are exceeded, other exceptions preventing the applicability of Section 8 may be available. In particular, if the competitive sales of either corporation are less than 2% of that corporation's total sales, or less than 4% of each corporation's total sales, the interlock is exempt. In addition, Section 8 provides a one-year grace period for an individual to resolve an interlock issue that arises as a result of an intervening event, such as a change in the capital, surplus and undivided profits or entry into new markets.

For the full text of our memorandum, please see:

- https://www.paulweiss.com/media/3984302/hart-scott-rodino_and_clayton_act_section_8_thresholds_for_2024.pdf

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

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