Paul | Weiss

CLIENT MEMORANDUM

July 12, 2024

Q2 2024 U.S. Legal & Regulatory Developments

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

1. Delaware General Assembly Approves 2024 Amendments to General Corporation Law

On June 20, 2024, the Delaware General Assembly passed legislation to amend provisions of the Delaware General Corporation Law ("DGCL"). Assuming they are signed by Governor John C. Carney, which is likely, the amendments will take effect on August 1, 2024 and will apply retroactively, but will not apply to or affect any completed or pending civil actions on or before the amendments' effective date. The amendments abrogate various recent Court of Chancery decisions that many practitioners had considered inconsistent with market practice. In particular, key changes effected by the amendments include: (i) expressly permitting stockholders agreements relating to corporate governance, such as consent rights over corporate actions; (ii) authorizing boards to approve agreements, instruments and other documents that require board approval under the DGCL, such as merger agreements, in final or "substantially final" form; (iii) clarifying that customary disclosure schedules delivered in connection with merger agreements are not part of the "agreement" that must be approved by the board and adopted by stockholders, and that the merger agreement need not include any provision relating to the survivor's charter in certain circumstances; and (iv) expressly permitting merger agreements to include "*Con-Ed*" provisions addressing "penalties and consequences" for non-performance, including reverse termination fees representing stockholders' lost transaction premium, as opposed to the target *entity*'s expectation or reliance damages.

Authorization of Stockholders Agreements

In *West Palm Beach Firefighters' Pension Fund* v. *Moelis & Co.* ("*Moelis*"), the Delaware Court of Chancery held that certain consent and other provisions in a stockholders agreement were facially invalid under the DGCL because they substantially restricted the ability of the board to manage the business and affairs of the corporation. The amendments enact a new subsection (18) of DGCL Section 122 (relating to a corporation's specific powers and permitted actions) that expressly authorizes corporations to contract with stockholders or beneficial owners of its stock on governance matters for such minimum consideration approved by the board, thus abrogating that portion of *Moelis*. In particular, new Section 122(18) expressly permits corporations to agree to take (or not to take) actions identified in a stockholders agreement, including to provide stockholders or directors with veto or consent rights over such actions, so long as they do not override any requirements for corporate action enumerated in the DGCL or the corporation's charter. For example, Section 242(b)(1) of the DGCL generally requires approval by the board and the stockholders (in that order) for a corporation to amend its charter. So while a stockholders agreement cannot eliminate that requirement, it may, pursuant to Section 122(18), contain a covenant prohibiting the corporation from amending the charter without first obtaining a particular stockholder's consent. Importantly, Section 122(18) addresses only the statutory validity of such provisions; it does not affect a board's or controlling stockholder's fiduciary duties in entering into, performing or exercising its rights under such agreements in any particular case, nor does it abrogate other principles articulated in existing case law.

© 2024 Paul, Weiss, Rifkind, Wharton & Garrison LLP. In some jurisdictions, this publication may be considered attorney advertising. Past representations are no guarantee of future outcomes.

Approval of Agreements

The amendments address the Court of Chancery's decision in *Sjunde Ap-Fonden* v. *Activision Blizzard, Inc.* ("*Activision*") in which the court considered (but did not conclusively decide) whether Section 251(b) of the DGCL requires boards to approve the final execution version of a merger agreement. The *Activision* court held that at a minimum the board must approve an "essentially complete" version of the merger agreement, which the court held the board in that case failed to do, as the approved version was missing disclosure schedules, the surviving company's charter, the consideration amount and the amount of dividends that the company could pay in the period between sign and close. In response to this holding, the amendments enact a new Section 147 of the DGCL, which provides that whenever the DGCL requires board approval of any "agreement, instrument or document," such document may be approved in "final form or in substantially final form." According to the legislative synopsis, a document is substantially final when all its material terms are either set out in the document or known to the board through other materials presented to it. For example, new Section 147 will permit a board to approve a merger agreement or a charter that does not specify a particular material term (such as the merger consideration or reverse stock split ratio in a charter amendment) if the board was otherwise aware of that term when it gave its approval (such as through a presentation identifying the final amount of consideration or split ratio). However, new Section 147 only addresses board approval of agreements, instruments and other documents; it does not authorize submitting such documents in substantially final form to stockholders. Nor does it affect fiduciary duties or equitable remedies in connection with the board's approval or taking of other actions in respect of the agreement, instrument or document so approved.

The amendments also enact a new Section 268 of the DGCL that addresses the *Activision* court's concerns that the board did not approve a final form of the surviving company's charter amendments or disclosure schedules related to a merger. Specifically, new Section 268 provides that disclosure letters, disclosure schedules or similar documents will not be deemed to be part of a merger agreement that must be approved by the board unless otherwise provided in the agreement. In addition, if a merger agreement (other than for a "holding company" merger under Section 251(g)) provides that all of the stock of a constituent will be converted into or exchanged for cash, property or securities (other than shares of the surviving corporation), then (i) the merger agreement required to be approved by the board need not include any provision relating to the survivor's charter to be considered in final or substantially final form, (ii) the board or any person acting at its direction may approve any amendment to the survivor's charter and (iii) no alteration or change to the survivor's charter will constitute an amendment to the merger agreement. According to the legislative synopsis, "[a]mong other things, this amendment will provide flexibility to a buyer in a typical 'reverse triangular merger' to adopt the terms of the [survivor's charter] that, following the effectiveness of the merger, will be wholly owned and controlled by the buyer." The synopsis also notes, however, that a target may still insist that the merger agreement provide for the survivor's charter in a particular form or that it contain specified provisions, such as those relating to indemnification and advancement of the corporation's directors and officers.

Authorization of Lost Premium Damages Provisions

The amendments modify Section 261 of the DGCL to clarify that a merger agreement may specify "penalties or consequences" for noncompliance prior to the effective time of the merger, including a "reverse termination fee" requiring a would-be acquiror in a failed transaction to pay the target an amount based on the stockholders' loss of the transaction premium. The amendments also expressly authorize, if specified in the merger agreement, the target itself to retain such stockholders' lost premium payments without any obligation to distribute them to the stockholders. Merger agreements commonly include such provisions, but the Court of Chancery recently suggested in *Crispo* v. *Musk* that they may be inconsistent with Delaware law. This amendment would reinstate the validity of such "*Con-Ed*" provisions in Delaware.

Conclusion

The amendments reflect the Delaware legislature's willingness and ability to address dislocations between the state's jurisprudence and market practice quickly and efficiently. As already mentioned, while the amendments make facially valid certain actions that the courts had found to violate the DGCL, directors, officers and stockholders remain bound by longstanding fiduciary duties, and also equitable principles developed by Delaware case law and policed by the Delaware courts on an as-applied basis.

For the full text of our memorandum, please see:

- https://www.paulweiss.com/media/3984934/delaware_general_assembly_approves_2024_amendments_to_general_corporation_law.pdf

For the full text of the amendments, please see:

- https://legis.delaware.gov/json/BillDetail/GeneratePdfDocument?legislationId=141480&legislationTypeId=1&docTypeId=2&legislationName=SB313

2. Delaware Supreme Court Affirms Two-Condition MFW Roadmap to Obtain Business Judgment Review of Controller Transactions

In an *en banc*, unanimous opinion in *In re Match Group, Inc. Derivative Litigation* ("*Match*"), the Delaware Supreme Court declined to provide a less burdensome path to business judgment review for self-interested controlling stockholder transactions that are not full "squeeze-out" mergers. Instead, the court's opinion, by Chief Justice Collins J. Seitz, Jr., confirms that, in all transactions where the controller stands on both sides and receives a non-ratable benefit (including in non-squeeze-outs), entire fairness is the presumptive standard of review and defendants must demonstrate that they satisfied *both* prongs of the framework set forth in *Kahn* v. *M & F Worldwide* Corp. ("*MFW*") to obtain business judgment review of the transaction—satisfying only one of the two protective measures will shift the burden of proving entire fairness to the plaintiff, but will not alter the standard of review. In addition, the opinion confirms that in the *MFW* setting, to replicate arm's-length bargaining, *all* committee members, not just a majority of the committee, must be independent of the controller. *Match* therefore affirms that *MFW* remains the only path under Delaware law to invoke business judgment review in self-interested controller transactions and clarifies the need to ensure the independence of each special committee member in order to rely on *MFW*'s protections.

Background

In its seminal 2014 *MFW* opinion, the Delaware Supreme Court held, in the context of a controller squeeze-out transaction where minority holders sell their shares and are not stockholders of the surviving entity, that the transaction will be subject to business judgment review if it is conditioned from the start on both (i) approval by a special committee of independent directors that is fully empowered and meets its duty of care and (ii) the fully informed, uncoerced vote of a majority of the minority stockholders. After *MFW* was decided, the Court of Chancery also applied the *MFW* framework in a series of non-squeeze-out cases where the controller received a non-ratable benefit, which raised the question whether it was necessary to do so in those circumstances in order to obtain business judgment review of those transactions.

Match also arose in the context of a controller, non-squeeze-out transaction, specifically the 2020 separation of Match from its controlling stockholder, IAC/InterActiveCorp ("IAC"). IAC had conditioned the transaction from the start upon approval by an independent special committee and a vote of a majority of the minority stockholders. The Match board formed a three-member separation committee and empowered the committee to, among other things, approve or disapprove any proposed separation transaction. The transaction was ultimately approved by both the separation committee and a majority of the minority stockholders.

The plaintiffs, minority stockholders of Match, brought direct and derivative claims alleging, among other things, that the transaction was a controller transaction subject to entire fairness review, and that the business judgment rule did not apply under *MFW* because the separation committee was not fully independent. Initially, the Court of Chancery dismissed the complaint upon finding that the transaction fully complied with the *MFW* requirements. Importantly, the Court of Chancery determined that the independent committee prong of the *MFW* framework was satisfied even though the complaint adequately alleged that one of the three directors on the separation committee lacked independence from IAC, reasoning that the allegedly non-independent director did not dominate or infect the proper functioning of the committee, which was comprised of a majority of independent directors.

For the full text of our memorandum, please see:

- https://www.paulweiss.com/media/3984613/delaware_supreme_court_affirms_two-condition_mfw_roadmap_to_obtain_business_judgment_review_of_controller_transactions.pdf

For the Delaware Supreme Court's opinion in *In re Match Group, Inc. Derivative Litigation*https://courts.delaware.gov/Opinions/Download.aspx?id=354960, please see:

- https://courts.delaware.gov/Opinions/Download.aspx?id=362250

3. Delaware Court of Chancery Applies Entire Fairness to Controlled Company's Move to Nevada

In *Palkon, et al.* v. *Maffei, et al.* ("*Maffei*") (an opinion by Vice Chancellor J. Travis Laster), the Delaware Court of Chancery denied a motion to dismiss claims that the directors and controlling stockholder of TripAdvisor and its parent entity breached their fiduciary duties of loyalty when they decided to convert the two entities—both Delaware corporations—into Nevada corporations. The court held that the conversions are subject to review for entire fairness because the entities' controlling stockholder is alleged to receive a non-ratable benefit (i.e., reduced litigation exposure) not shared by the common stockholders. Nevertheless, the court explained that, even if the plaintiffs prevailed on the merits, it would not enjoin the conversions because any resulting harms could be compensated by monetary damages based on any decline in the valuation of the company after announcement of the conversion. Although *Maffei* applies traditional controlling stockholder doctrine to the potential benefit of changing the entity's state of incorporation, the decision demonstrates that the Court of Chancery is unlikely to award the extreme remedy of enjoining the conversion if there is any potential that monetary damages could compensate the harm.

For the full text of our memorandum, please see:

- https://www.paulweiss.com/media/3984612/delaware_ma_quarterly_spring_2024.pdf

For the Delaware Court of Chancery's opinion in *Palkon, et al.* v. *Maffei, et al.*, please see:

- https://courts.delaware.gov/Opinions/Download.aspx?id=360330

4. Delaware Court of Chancery Holds That Director Was Not Permitted to Share Confidential and Privileged Information with Affiliated Stockholder

In *Icahn Partners LP* v. *deSouza* (an opinion by Vice Chancellor Paul A. Fioravanti Jr.), the Delaware Court of Chancery held that a director elected to the board after a proxy contest run by a 1.4% stockholder of the corporation was not entitled to share confidential or privileged information about the corporation received in his capacity as a director. In connection with his election to the board, the director signed a questionnaire in which he agreed to comply with the corporation's code of conduct, including a requirement that directors not share privileged or confidential company information. The director nevertheless gave such information to the stockholder who nominated him, and the stockholder used the information in a lawsuit against the corporation. The corporation then moved to strike the information from the complaint. The court granted the motion, holding that the director breached his duties in sharing the information. The court held that directors may share privileged or confidential information in two scenarios: (i) where the director is designated pursuant to a contract or the stockholder's voting power and (ii) where the director serves in a controlling or fiduciary capacity with the stockholder. This latter category includes what the court called "one brain" situations (i.e., where the director is the controller of the corporation or a fiduciary to the controller and is of "one mind" in the sense that it cannot be expected that he or she not use the information known in his or her capacity as a director in his or her decision-making as a stockholder or stockholder fiduciary). Here, the stockholder did not have a contractual right (or the voting power) to appoint the director, and the director did not owe a fiduciary duty to the stockholder (he was an employee of the stockholder with no fiduciary duties to it). Therefore, it was a breach of his duty to share the confidential and privileged information with the stockholder and the court granted the motion to strike.

For the full text of our memorandum, please see:

- https://www.paulweiss.com/media/3984612/delaware_ma_quarterly_spring_2024.pdf

For the Delaware Court of Chancery's opinion in *Icahn Partners LP* v. *deSouza,* please see:

- https://courts.delaware.gov/Opinions/Download.aspx?id=358430

5. Federal Jury Finds Defendant Liable in SEC "Shadow Trading" Case

On Friday, April 5, 2024, a jury in the Northern District of California found that the SEC had established that Defendant Matthew Panuwat, a former senior director of business development at biopharmaceutical firm Medivation Inc. ("Medivation"), was liable under a civil misappropriation theory of insider trading for violations of Section 10(b) of the Exchange Act and SEC Rule 10b-5. Panuwat bought $117,000 in call options in the stock of biopharmaceutical firm Incyte Corporation ("Incyte") seven minutes after receiving an email from Medivation's CEO that Medivation was "on track to sign [a] deal" for Pfizer Inc. ("Pfizer") to acquire Medivation. When the merger was announced four days later, Incyte's stock price increased, and Panuwat began selling shares, realizing over $100,000 in profits. This insider trading theory is known as "shadow trading"—possessing insider information about a company and trading in the shares of a similarly situated competitor.

The trial lasted eight days. The SEC called as witnesses an investment banker who worked on the Medivation-Pfizer deal, who testified as to Panuwat's involvement in the confidential bidding process, and the SEC's deputy chief economist, who testified that market observers would have expected a "spillover effect" on Incyte's stock after the Medivation-Pfizer deal was announced. This "spillover effect" was to be expected, she testified, because analyst reporting had linked Medivation and Incyte before the deal was announced and noted they were similarly situated and because, when a company makes a big announcement that causes an increase in its stock price, it is typical to see a similar bump in stock price across the industry. In pursuing the lawsuit, the SEC has relied on, among other things, Medivation's insider trading policy, which prohibited trading in a non-exhaustive list of other public companies' securities, to help establish that Panuwat had breached a duty of trust and confidence he owed to Medivation.

Panuwat called his former Medivation colleague, who testified that Medivation and Incyte were not competitors and that he did not see a correlation between their stocks, before Panuwat took the stand to explain that he had been monitoring Incyte stock for over a month before buying call options, after reading an analyst report recommending purchasing Incyte call options. Panuwat's lawyers argued that he could not have had an intent to defraud because he did not think that trading in Incyte stock could be considered insider trading. On cross-examination, the SEC probed why Panuwat now had a detailed explanation for his purchase, but had not provided this explanation in his earlier deposition testimony, and repeatedly questioned Panuwat whether his purchase of Incyte call options moments after receiving an email about the Medivation-Pfizer deal was "just a coincidence."

After the jury returned its verdict, the presiding judge, Judge Orrick, requested that the parties submit a joint statement on proposed remedies and offered to assign a magistrate judge to assist in that process. The SEC is seeking a fine up to three times Panuwat's trading gain and to bar Panuwat from serving as an officer or director of any public company. Panuwat is likely to appeal the judgment to the Ninth Circuit, which may consider whether "shadow trading" is able to support a Section 10(b) and Rule 10b-5 claim as a matter of law and if there was sufficient evidence to support the jury verdict.

The SEC released a statement from Division of Enforcement Director Gurbir Grewal that the case was "nothing novel" and was instead "insider trading, pure and simple." But as we have previously observed, this case marks what appears to be the first time the SEC has brought a lawsuit alleging that information about one company could be considered material to investors in another company because of the companies' substantial similarities or connections. The verdict is thus likely to embolden the SEC's enforcement of suspected "shadow trading" where it believes there is sufficient evidence of correlation between the stock performance of two companies and that information material to one company would be considered material to investors in the

other. The SEC's action also underscores the importance of the specific terms of a company's insider trading policy to the question of whether an employee has breached a relevant duty by engaging in shadow trading. Companies may wish to review the scope of their insider trading policy and ensure that those subject to the policy are aware of its scope.

For the full text of our memorandum, please see:

- https://www.paulweiss.com/media/3984585/federal_jury_finds_defendant_liable_in_sec_-shadow_trading-_case.pdf

6. Congress Expands U.S. Sanctions in National Security Omnibus Bill

On April 24, 2024, President Biden signed into law a national security and foreign aid omnibus bill, H.R. 815 (the "Act"). While public attention focused on the significant foreign aid to Israel, Ukraine, and Taiwan, and the provision relating to the forced divestment of TikTok, the Act also includes significant provisions relating to U.S. sanctions. Most notably, the Act doubles the statute of limitations for criminal and civil violations of U.S. sanctions, establishes authorities for confiscating and transferring Russian sovereign assets to Ukraine and provides the President with both new mandatory and permissive sanctions authorities involving various regions, including Iran, China, and Russia, and regarding terrorism financing, malicious cyber activities and trafficking fentanyl and captagon.

Extending the Statute of Limitations for Sanctions Violations to 10 Years

The Act extends the statute of limitations for civil and criminal sanctions violations from five to 10 years. The 10-year statute of limitations will apply to all violations on a go-forward basis, as well as to any prior violations that had not been time-barred under the five-year statute of limitations by the date of enactment (April 22, 2024). Under well-settled principles, the new statute of limitations would not apply to revive sanctions violations that were already time-barred.

Doubling the statute of limitations could increase the scope of liability and therefore the extent of penalties for companies that face criminal or civil sanctions enforcement. Companies engaging in M&A activity or in other types of transactions may want to expand the scope of their due diligence to account for the longer limitations period. These companies may also consider whether to extend the lookback period for sanctions representations and warranties. Banks and other lenders may also consider taking a similar approach.

Mandatory Sanctions Provisions

Several provisions of the Act require the President to impose sanctions on foreign persons that the President determines have engaged in specified acts. Some of these provisions impose sanctions on foreign persons that engage in transactions with sanctioned parties. In practice these types of provisions are not truly "mandatory"—they require the President to impose sanctions against individuals and entities after he determines that they have engaged in certain activities, thus allowing the President to theoretically refrain from implementing these sanctions by withholding certain determinations.

We expect that the Office of Foreign Assets Control ("OFAC") will issue guidance in the coming months on how it will approach these provisions.

Chinese Financial Institutions

- Prior to the new legislation, Section 1245(d) of the National Defense Authorization Act for Fiscal Year 2012 required the imposition of blocking sanctions on foreign financial institutions that the President determines have "knowingly conducted or facilitated any significant financial transaction with the Central Bank of Iran or another Iranian financial institution [designated by the Secretary of the Treasury]." The Act amends the Iran-China Energy Sanctions Act of 2023 to expand the definition of "significant financial transaction" to include any transaction (1) "by a Chinese financial institution (without regard to size, number, frequency, or nature of the transaction) involving the purchase of petroleum or petroleum products from Iran"; and (2) "by a foreign financial institution (without regard to the size, number, frequency, or nature of the transaction) involving the purchase of Iranian unmanned aerial vehicles (UAVs), UAV parts, or related systems." This

expanded definition aims to cast a wider net on banking services supporting the purchase of Iranian petroleum, petroleum products, UAVs, UAV parts, and UAV systems.

- Not later than 180 days after the date of enactment, the President is required to determine whether any Chinese financial institution or other financial institution has engaged in a significant financial transaction (in each case as newly defined), and transmit such determination to the proper congressional committees.

Iran

- *Transactions or Dealings Involving Oil*. The Act authorizes (and in some instances requires) the President to impose additional sanctions or visa restrictions on foreign persons involved in transactions related to Iranian petroleum products. This includes owners or operators of foreign ports that allow vessels on OFAC's list of specially designated nationals and blocked persons to dock; those engaging in significant transactions involving Iranian petroleum products; and individuals owning or operating vessels conducting ship-to-ship transfers of such products. Additionally, these sanctions extend to refinery owners processing Iranian petroleum, covered family members of foreign persons, and entities under foreign persons' ownership or control. The term "covered family member," with respect to a foreign person who is an individual, means "a spouse, adult child, parent or sibling of the person who engages in the sanctionable activity [] or who demonstrably benefits from such activity."

- *Participation or Support in Missile and Drone Program*. The Act requires the President to impose sanctions and visa restrictions on any foreign person that the President determines has "knowingly" engaged in, provided support to (financially, materially, or technologically), or participated in Iran's missile and drone program. The sanctions also apply to adult family members of such foreign persons.

- *Iranian Government Officials*. The Act states that the President is required to determine by July 23, 2024 whether (1) the Supreme Leader of Iran, President of Iran, and other individuals and entities should be subject to sanctions for complicity in human rights abuses or the support of terrorism and (2) "any official of any entity owned or controlled by the Supreme Leader of Iran or the Office of the Supreme Leader of Iran" should be sanctioned under existing authorities. The Act also gives Congress the authority to refer names to the President of individuals who it believes meet the criteria for sanctions under one or more of these programs and authorities. In turn, the Act provides that, within 60 days, the President must determine if the person meets such criteria.

Terrorism-Related Sanctions

- *Hamas.* The Act requires the President to impose blocking sanctions on each foreign person that the President determines "knowingly" (1) assists in supporting or providing significant financial, material, or technological support for, or goods or other services to enable, acts of terrorism; or (2) engages, directly or indirectly, in a significant transaction with—(a) "a senior member of Hamas, Palestinian Islamic Jihad" or other terrorist organizations, or (b) "a senior member of a foreign terrorist organization" that provides support to Hamas, Palestinian Islamic Jihad, or other terrorist organizations.

Drug Trafficking-Related Sanctions

- The Act requires the President to impose blocking sanctions and visa restrictions on any foreign person the President determines "is knowingly involved in the significant trafficking of fentanyl, fentanyl precursors, or other related opioids, including such trafficking by a national crime organization" or "otherwise is knowingly involved in significant activities of a transnational criminal organization" relating to such activities. Similarly, the Act requires the President to impose blocking sanctions and visa restrictions on foreign persons the President determines "materially contributed" to the "international proliferation of captagon," an "amphetamine-type stimulant."

Violence Against U.S. Officials

- The Act provides that within 180 days of enactment, the President is required to impose blocking sanctions and visa restrictions on foreign persons the President determines has "ordered, directed, or taken material steps to carry out any use

of violence or has attempted or threated to use violence against any current or former official of the Government of the United States."

In addition to these mandatory provisions, the Act also requires the President to impose blocking sanctions and visa restrictions on "any foreign person that the Secretary of the Treasury, in consultation with the Attorney General and the Secretary of State determine" is "responsible for, complicit in, or has engaged knowingly in, significant cyber-enabled activities" that pose a "significant threat to the national security, foreign policy, or economic health or financial stability of the United States," as well as any such person that materially assists, sponsors, or provides support for malicious cyber activities, is the target of blocking sanctions or is "owned or controlled by, or has acted or purported to act for or on behalf of [] any person" who is subject to blocking sanctions for engaging in such activity.

Transfer of Russian Sovereign Assets

The Act notes that approximately $300 billion in Russian sovereign assets have been immobilized on a global level, with approximately $4 billion to $5 billion of those assets subject to U.S. jurisdiction. Over the past year, there have been growing demands for the United States and its partners to confiscate those funds and transfer them to Ukraine.

The existing statutory authority only allowed the President to freeze these assets and limited confiscation to circumstances where the "United States is engaged in armed hostilities or has been attacked by a foreign country or foreign nationals." The Act grants the President new authority to "seize, confiscate, transfer, or vest any Russian aggressor state sovereign assets" for the purpose of making them available to Ukraine, through a new "Ukraine Support Fund," which is to be administered by the State Department for the purpose of supporting Ukraine's recovery efforts.

While the Act does not require the President to seize and transfer these assets, it does seek to limit the possibility that the funds would be released as part of any potential resolution to the conflict. The statute states that blocked or effectively immobilized assets cannot be released until the President certifies to Congress that hostilities have ended and Russia has issued "full compensation" to Ukraine for the invasion.

Report on Sanctions Imposed by European Partners

The Act requires the President to submit by July 23, 2024 a report identifying foreign persons that have been sanctioned by the EU or the UK under their Russia-sanctions authorities and that the President determines would be eligible to be sanctioned by the United States under the Global Magnitsky Human Rights Accountability Act (relating to corruption and human rights abuses) and Russia-related Executive Orders. The Act does not require that the President issue sanctions against these persons, but the process of producing this list—and the requirement to notify Congress of which persons have not been designated by OFAC—may create pressure to designate those persons.

Conclusion

Companies should factor the potential for the new sanctions into their risk assessments and determine whether any of their ongoing activities may subject them or their business partners or counterparties to the threat of sanctions.

For the full text of our memorandum, please see:

- https://www.paulweiss.com/media/3984751/congress_expands_us_sanctions_in_national_security_omnibus_bill.pdf

For the full text of the Act, please see:

- https://www.congress.gov/118/bills/hr815/BILLS-118hr815eah.pdf

7. SEC Staff Clarifies Form 8-K Reporting Requirements for Cyber Incidents

On May 21, 2024, the SEC's Director of the Division of Corporation Finance, Erik Gerding, published a statement urging public companies to report only material cyber incidents under the SEC's new cybersecurity rules. Those rules, which the SEC adopted in July 2023 and went into effect for most companies on December 18, 2023, require public companies to disclose material cybersecurity incidents under new Item 1.05 of Form 8-K. When adopting the new rules, the SEC stated that Item 1.05 "is not triggered until the company determines the materiality of an incident." Notwithstanding that guidance, many of the disclosures made under Item 1.05 in the five months since the rule took effect have included statements that the company making the disclosure has not yet determined that the incident is material or, in some cases, has determined that the incident is not material. Although acknowledging that such disclosures are not expressly prohibited by the text of Item 1.05, Gerding warns that disclosing such immaterial (or not yet material) incidents under Item 1.05 "could be confusing for investors," and he encourages companies to disclose such incidents under a different item of Form 8-K, such as Item 8.01 (Other Events).

Background: The July 2023 Rule on Reporting Material Cyber Incidents

Item 1.05 of Form 8-K requires specified disclosure of material cybersecurity incidents. Whether a cybersecurity incident is material is determined by the same materiality principles articulated repeatedly by the courts and the SEC—namely whether there is a substantial likelihood that a reasonable investor would consider it important.

Under Item 1.05 of Form 8-K, companies must, within four business days of their determination that a "material cybersecurity incident" has occurred, file a Form 8-K describing the material aspects of the nature, scope, and timing of the incident, and the material impact or reasonably likely material impact on the company, including its financial condition and results of operations. If any information required by Item 1.05 is not determined or unavailable at the time the Form 8-K filing is required, companies must file an amendment to the Form 8-K to include such disclosure within four business days of determination or availability.

Clarification: Reporting Incidents That Are Immaterial or for Which a Company Has Not Yet Made a Materiality Determination

While the SEC may have expected Item 1.05 to be used only to report material cyber incidents, in the five months since the rule took effect more than a dozen companies have disclosed incidents under Item 1.05 that the companies have not yet determined are material—and therefore do not require disclosure under Item 1.05. This unexpected practice has resulted in an increase in the overall number of Form 8-K disclosures regarding cybersecurity incidents. But because Item 1.05 was added to Form 8-K to require the disclosure of a cybersecurity incident "that is determined by the registrant to be material," and, in fact, the item is titled "Material Cybersecurity Incidents," Gerding suggests that "it could be confusing for investors if companies disclose either immaterial cybersecurity incidents or incidents for which a materiality determination has not yet been made under Item 1.05."

Gerding does not suggest that such incidents should not be disclosed. He "recognize[s] the value of such voluntary disclosures to investors, the marketplace, and ultimately to companies, and [his] statement is not intended to disincentivize companies from making those disclosures." Rather, his statement is intended to encourage companies to report immaterial incidents under a different item of Form 8-K, not Item 1.05.

Given the prevalence of cybersecurity incidents, this distinction between a Form 8-K filed under Item 1.05 for a cybersecurity incident determined by a company to be material and a Form 8-K voluntarily filed under Item 8.01 for other cybersecurity incidents will allow investors to more easily distinguish between the two and make better investment and voting decisions with respect to material cybersecurity incidents. By contrast, if all cybersecurity incidents are disclosed under Item 1.05, then there is a risk that investors will misperceive immaterial cybersecurity incidents as material, and vice versa.

Takeaways

Public companies should carefully consider the specific item of Form 8-K under which they disclose cybersecurity incidents. Companies can also expect the SEC to vigorously enforce disclosure requirements related to cybersecurity incidents. For example, on May 22, 2024, Intercontinental Exchange Inc., the parent company of the New York Stock Exchange, agreed to pay a $10 million penalty to settle allegations that it failed to comply with its obligation under a different rule (Regulation Systems Compliance and Integrity, or Regulation SCI) to immediately notify the SEC of an April 2021 cybersecurity incident. The SEC also

continues to prosecute its complaint against SolarWinds Corp. and the company's Chief Information Security Officer for allegedly misleading disclosures in December 2020 about a cybersecurity incident. These enforcement actions, considered alongside the new disclosure rules and efforts by Gerding and other staff to engage with industry regarding these rules, signal the SEC's commitment to aggressively policing companies' cybersecurity disclosures.

For the full text of our memorandum, please see:

- https://www.paulweiss.com/media/3984806/sec_staff_clarifies_form_8-k_reporting_requirements_for_cyber_incidents.pdf

For the full text of the SEC's statement, please see:

- https://www.sec.gov/news/statement/gerding-cybersecurity-incidents-05212024?utm_medium=email&utm_source=govdelivery

8. Supreme Court Decides Pure Omissions Are Not Actionable Under Rule 10b-5(b) in *Macquarie Infrastructure Corp.* v. *Moab Partners, L.P.*

On April 12, 2024, the Supreme Court issued its decision in *Macquarie Infrastructure Corp.* v. *Moab Partners, L.P.* (Paul, Weiss represents defendant-respondent Barclays Capital Inc. in this matter), unanimously holding that a failure to disclose information required by Item 303 of Regulation S-K cannot support a private claim under Rule 10b-5(b) of the Securities Exchange Act of 1934, as amended (the "Exchange Act") in the absence of an otherwise-misleading statement. The decision confirms that "pure omission" claims are not actionable under Rule 10b-5(b), meaning that plaintiffs claiming an "omission" of a material fact under Rule 10b-5(b) must show that the omission rendered statements made by the defendant misleading.

Background

Section 10(b) of the Exchange Act broadly prohibits deception in connection with the purchase or sale of securities. Rule 10b-5(b) provides a private cause of action for investors and shareholders to sue a public company if it "make[s] any untrue statement of a material fact or [ ] omit[s] to state a material fact necessary in order to make the statements . . . not misleading." Item 303 of the Securities and Exchange Commission's (the "SEC") Regulation S-K requires public company management to provide investors with an understanding of how market trends or changes may affect the company's financial performance. Specifically, Item 303 requires public companies to disclose "a[ny] trend, demand, commitment, event or uncertainty" that is both "presently known to management and reasonably likely to have material effects on the registrant's financial conditions or results of operations." Item 303 does not provide shareholders or investors with a private cause of action for alleged violations of its disclosure requirements. The SEC may, at its discretion, choose to sue a public company to enforce investors' rights under Item 303.

In this case, defendant Macquarie Infrastructure Corporation ("Macquarie") is a former publicly traded company that owns and operates a large portfolio of businesses related to infrastructure. One of these portfolio companies was International-Matex Tank Terminals ("IMTT"), a bulk liquid storage service that is used to store refined petroleum products. IMTT primarily stores a fuel type called No. 6 fuel oil. In 2020, the International Maritime Organization adopted a new regulation, known as "IMO 2020," that significantly restricted the use of No. 6 fuel oil by applying a cap on the allowable level of sulfur in fuel oil and banning the use of fuels with sulfur contents of 0.5% or more.

In February 2018, Macquarie missed its financial projections and announced that IMTT's storage tank capacity use had dropped and that the falling sale price of No. 6 fuel oil had led to many of IMTT's customers terminating its storage contacts. The stock price fell around 41%.

In response, Moab Partners L.P. ("Moab"), representing a class of Macquarie investors, brought suit, alleging that Macquarie defrauded its investors from 2016 to 2018 by failing to predict and disclose the high material risk of the proposed IMO 2020

regulation on IMTT's business. In particular, Moab argued that Macquarie failed to disclose IMTT's high level of reliance on No. 6 fuel oil.

Proceedings Below

Moab sued Macquarie and various other defendants in the Southern District of New York, alleging that Macquarie violated Rule 10b-5(b) by concealing from investors the extent to which IMTT relied on No. 6 fuel oil and the likely material effects of IMO 2020 on its financial condition. Moab argued that Macquarie had a duty to disclose this information under Item 303, and that this pure omission constituted a misrepresentation of material fact under Section 10(b) of the Exchange Act. The district court granted Macquarie's motion to dismiss, holding that (1) Moab did not plead any *actionable misstatements* by Macquarie that would give rise to liability under Rule 10b-5(b), and (2) Macquarie was not obligated under Item 303 to make disclosures about IMTT's reliance on No. 6 fuel oil storage.

The Second Circuit vacated the district court's judgment. The Second Circuit reasoned that Moab did plead actionable omissions under Section 10(b), and that Macquarie did have an obligation under Item 303 to make the IMTT-related disclosures because Macquarie and its officers were aware of the impact that IMO 2020 may have on its financial performance.

The Supreme Court granted certiorari on the question of whether the Second Circuit erred in holding that a failure to make a disclosure required under Item 303 of SEC Regulation S-K can support a private claim under Section 10(b) of the Exchange Act, even in the absence of an otherwise misleading statement.

Supreme Court Decision

In a unanimous opinion written by Justice Sotomayor, the Supreme Court held that pure omissions are not actionable under Rule 10b-5(b).

The Court reasoned that Rule 10b-5(b) requires plaintiffs to identify affirmative statements, i.e., a "statement made," before determining if other facts are needed to make those statements "not misleading." Focusing on the text of Rule 10b-5(b), the Court explained that it required disclosure of information only when necessary to ensure that statements already made were clear and complete. The Court compared that language to the language of Section 11(a) of the Securities Act of 1933, which the Court interpreted expressly to create liability for a pure omission where the regulated party has a duty to speak.

The Court also rejected Moab's argument that a failure to disclose information required by Item 303 of SEC Regulation S-K can support a private 10b-5(b) claim in the absence of an otherwise misleading statement. The Court held that an omission is only actionable if the omission renders otherwise-made affirmative statements misleading. In particular, the Court distinguished between "pure omissions"—which it held are not actionable under Rule 10b-5(b)—and "half-truths"—which are actionable under Rule 10b-5(b). The Court noted that private parties can still bring a claim for Item 303 violations that create misleading half-truths, and that the SEC can still prosecute violations of Item 303.

The Court's decision clarifies the scope of actionable "omissions" under Rule 10b-5(b), confirming that, at least under Rule 10b-5(b), even an independent duty to disclose does not automatically render silence misleading. Notably, while the parties in briefing and at oral argument at the Supreme Court had argued over the proper analysis to apply to "half-truths," the Court declined to provide further guidance on when a statement is misleading as a half-truth, or whether Rules 10b-5(a) and 10b-5(c)—the "scheme liability" subsections—would support liability for pure omissions. Courts at the trial and appellate level regularly address when omissions of fact render affirmative statements misleading "half-truths," so public companies still have precedent to draw on in crafting disclosures.

For the full text of our memorandum, please see:

- https://www.paulweiss.com/media/3984626/supreme_court_decides_pure_omissions_are_not_actionable_under_rule_10b-5-b-_in_macquarie_infrastructure_corp_v_moab_partners-_lp.pdf

For the Supreme Court's opinion in *Macquarie Infrastructure Corp.* v. *Moab Partners, L.P.*, please see:

- https://www.supremecourt.gov/opinions/23pdf/22-1165_10n2.pdf

9. DOJ Announces New Whistleblower Program Aimed at Increasing Corporate Enforcement

On March 7, 2024, Deputy Attorney General Lisa Monaco ("DAG Monaco") announced that the U.S. Department of Justice (the "DOJ") will launch a new whistleblower program this year (the "DOJ Program" or the "Whistleblower Program") that is intended to "create new incentives for individuals to report misconduct" to the DOJ and "drive companies to invest further in their own internal compliance and reporting systems."

While a number of federal agencies currently have whistleblower programs, DAG Monaco noted that these programs only cover crimes within their jurisdictions, creating a "a patchwork quilt that doesn't cover the whole bed." According to DAG Monaco, the DOJ Program aims to "fill gaps" in existing whistleblower programs by covering criminal activity where there is not already an existing program, including the SEC, Commodity Futures Trading Commission ("CFTC"), Internal Revenue Services ("IRS"), and Financial Crimes Enforcement Network ("FinCEN") whistleblower programs. See Appendix A of our full memorandum, hyperlinked below, for a description of the existing programs.

Under the new DOJ program, "if an individual helps DOJ discover significant corporate or financial misconduct—otherwise unknown to us—then the individual could qualify to receive a portion of the resulting forfeiture." DAG Monaco highlighted that if an employee at a private equity firm or a technology start-up discovers financial fraud or bribery, the whistleblower would be able to "get paid as part of the recovery from that criminal case." The DOJ will be "especially interested" in information about: criminal abuses of the U.S. financial system; foreign corruption outside the jurisdiction of the SEC, including FCPA violations by non-issuers, and violations of the recently enacted Foreign Extortion Prevention Act; and U.S. domestic corruption cases, especially involving illegal corporate payments to government officials.

The Whistleblower Program is a significant development in the DOJ's focus on corporate criminal enforcement and fits within the DOJ's continued initiatives to encourage companies to file Voluntary Self-Disclosures ("VSD") of potential violations. DAG Monaco underscored this point, noting that the DOJ's message to companies "considering a voluntary self-disclosure" is that they should "knock on our door before we knock on yours."

Design and Implementation

The DOJ has provided limited information about the new program so far, but DAG Monaco explained in her March 7 speech that the DOJ would be "launching a 90-day sprint to develop and implement a pilot program," during which the DOJ would "gather information, consult with stakeholders, and design a thoughtful, well-informed program." The DOJ's Money Laundering and Asset Recovery Section ("MLARS") will be at the forefront of that effort since the DOJ's statutory authority to administer the whistleblower program is "tied to the department's forfeiture program." Whether the DOJ will ultimately administer its program through a central whistleblower office, like those that administer the SEC, CFTC, IRS, and FinCEN programs, remains to be seen.

DAG Monaco also explained that there will be certain parameters limiting the scope of the program. Specifically, the DOJ intends to offer payments only (i) after all victims have been properly compensated; (ii) to those who submit truthful information not already known to the government; and (iii) to those not involved in the criminal activity itself.

As with other whistleblower programs, the DOJ Program will only pay awards to individuals who are "first in the door." DAG Monaco emphasized that this point is key "[b]ecause the same rule applies to the Department's [VSD] programs." The restriction applies "regardless of whether [the reporting individual or entity is] an innocent whistleblower, a potential defendant looking to minimize criminal exposure, or the audit committee of a company where the misconduct took place." The result will be a "multiplier effect" where companies and individuals are both incentivized to be first to report corporate misconduct.

In a March 8 speech, Acting Assistant Attorney General Nicole M. Argentieri explained that MLARS intends to work closely with U.S. Attorneys, the FBI, and other DOJ offices to develop the program guidelines for eligibility. One such guideline may be a monetary threshold like those the SEC and CFTC use for their whistleblower programs. While the SEC and CFTC limit rewards to cases in which the agency orders at least $1 million in sanctions, the DOJ may ultimately choose to set a different threshold.

It remains to be seen how the new DOJ-wide policy will relate to recent whistleblower initiatives announced by the U.S. Attorney's Office for the Southern District of New York ("SDNY") and the U.S. Attorney's Office for the Northern District of California ("NDCA"). In January 2024, the SDNY announced its own corporate whistleblower pilot program, which will focus on "self-disclosure of criminal conduct." The policy will be "applicable to circumstances where an individual discloses to [the] Office information regarding criminal conduct undertaken by or through public or private companies, exchanges, financial institutions, investment advisers, or investment funds involving fraud or corporate control failures or affecting market integrity, or criminal conduct involving state or local bribery or fraud relating to federal, state, or local funds." In exchange for self-disclosure and cooperation, SDNY "will enter into a non-prosecution agreement where certain specified conditions are met," including that the government was not previously aware of the disclosed information. As such, unlike the DOJ Program, the SDNY pilot program incentivizes whistleblowers with non-prosecution, rather than monetary awards. The NDCA recently announced that it plans to launch a similar program soon.

Compliance Considerations

Although the DOJ Program is still being defined, it is clear that the DOJ is continuing to aggressively incentivize individuals and companies to provide the DOJ with information about corporate misconduct. As a result, there are a number of steps that potentially impacted companies should consider.

- Because the DOJ Program will cover a range of potential illicit activity, including fraud and bribery, companies should consider reviewing and updating their whistleblowing policies and procedures (or adopting them if needed). These policies and procedures should address the assessment and prompt internal investigation of allegations of misconduct, as well as non-retaliation against whistleblowers (and avenues for whistleblowers to seek recourse in the event there is retaliation).

- Companies may also wish to consider developing a clear framework for reporting potential violations internally so that the company will be well positioned to evaluate when and how to avail itself of the DOJ Program.

For the full text of our memorandum, please see:

- https://www.paulweiss.com/media/3984503/doj_announces_new_whistleblower_program_aimed_at_increasing_corporate_enforcement.pdf

For Deputy Attorney General Lisa Monaco's keynote remarks, please see:

- https://www.justice.gov/opa/speech/deputy-attorney-general-lisa-monaco-delivers-keynote-remarks-american-bar-associations

10. New Merger Guidelines Feature Prominently in FTC Handbag Merger Challenge

- The Federal Trade Commission (the "FTC") recently sued to block Tapestry, Inc.'s ("Tapestry") proposed acquisition of Capri Holdings Limited ("Capri"), alleging that the effect of the combination of the companies' handbag brands may be to substantially lessen competition.

- The complaint relies heavily on the December 2023 FTC-DOJ Merger Guidelines (the "2023 Merger Guidelines") and presents one of the first opportunities for a federal court to weigh in on the validity of several theories of harm described in those guidelines.

On April 22, 2024, the FTC initiated administrative and federal district court proceedings to block Tapestry's proposed $8.5 billion acquisition of Capri, which, if consummated, would bring the Coach, Kate Spade and Michael Kors handbag brands together under the same holding company. The FTC alleges that the execution of the parties' merger agreement was, and the proposed acquisition would be, an "unfair method of competition" in violation of Section 5 of the Federal Trade Commission Act of 1914 and that the effect of the proposed acquisition "may be substantially to lessen competition, or to tend to create a monopoly" in violation of Section 7 of the Clayton Antitrust Act of 1914 (the "Clayton Act"). In its complaints, the FTC asserts several theories of competitive harm described in the new 2023 Merger Guidelines, and this litigation presents one of the first opportunities for a federal court to weigh in on the validity of those guidelines. The court has scheduled an evidentiary hearing on the FTC's motion for preliminary injunction to begin on September 9, 2024.

The FTC alleges that the proposed acquisition would violate the law in several ways: (i) it would result in the elimination of significant head-to-head competition between the handbag brands; (ii) it would significantly increase concentration in an alleged market for "accessible luxury" handbags in the United States; (iii) it would result in significant effects on the wages, benefits and working conditions of employees of the merging parties; and (iv) it is part of Tapestry's "anticompetitive pattern and strategy for acquisitions." Each of these theories of competitive harm is discussed in the 2023 Merger Guidelines.

Elimination of Direct Head-to-Head Competition

Guideline 2 of the 2023 Merger Guidelines outlines how the agencies look at the degree of competition between the merging firms to predict whether a merger may substantially lessen competition in violation of Section 7. Similarly, under the prior Horizontal Merger Guidelines the agencies also "consider[ed] whether the merging firms have been . . . substantial head-to-head competitors." The discussion in the new guidelines lists a "variety of indicators to identify substantial competition," including evidence that the two firms make strategic decisions in the ordinary course of business with reference to each other and evidence of "competitive actions by one of the merging firms" impacting the other merging firm.

Product Competition

Consistent with Guideline 2 of the 2023 Merger Guidelines, the FTC alleges that the proposed acquisition would eliminate head-to-head competition between Coach, Kate Spade and Michael Kors and this would result in "increased prices, fewer discounts and promotions, [and] decreased innovation . . . ." The FTC cites internal documents that purport to show Tapestry and Capri closely monitoring each other's business strategies and responding to the other's competitive decision-making. Coach, Kate Spade and Michael Kors, according to the FTC, have a "laser-like focus on each other" for pricing and discounting, marketing, brick-and-mortar stores and innovation and design. The FTC goes on to allege that Tapestry "intends to raise prices for Michael Kors through reducing discounts and promotions and pulling back on wholesale."

Labor Competition

The FTC also alleges that the proposed acquisition would eliminate head-to-head competition between the companies for workers, resulting in "reduced wages and employee benefits." Among other things, the FTC alleges that the companies compete with each other for workers on several dimensions, including work environment, compensation, leave policies, promotions and training programs. The FTC argues that the proposed acquisition would result in "substantial effects on employment wages, benefits and conditions for people who work for or seek employment from the parties and their brands." The focus on labor is also consistent with Guideline 10, which notes that the FTC and DOJ will examine whether a merger between "buyers of labor" may substantially lessen competition and result in "lower wages or slower wage growth, worsening benefits or working conditions, or other degradation of workplace quality." Labor was not mentioned in the previous merger guidelines.

Significant Increases in Concentration

Consistent with Guideline 1 of the 2023 Merger Guidelines, the FTC alleges that the proposed acquisition is presumptively unlawful because it would significantly increase concentration in the "accessible luxury" handbag market—a moniker the complaint notes Coach "gave birth to" two decades ago. This is the only theory in the complaint that explicitly relies on a defined product market. In alleging this purported market, the FTC relies heavily on the parties' ordinary course business documents,

including those that describe “accessible luxury” as a distinct handbag product with a distinct customer base in contrast with the “mass-market” and “true luxury” segments of the handbag industry.

Market Definition
Consistent with the 2023 Merger Guidelines, the FTC’s product market definition is based on evidence of substantial competition between the merging parties for the sale of “accessible luxury” handbags as well as evidence of observed market characteristics (“practical indicia”). For the latter, the FTC relies on a range of evidence, including usage of the term in the parties’ 10-Ks and earnings calls as well as more broadly by industry participants such as the press and analysts. Lastly, the FTC outlines the various “peculiar characteristics” of the “accessible luxury” handbag. These include unique quality materials and craftsmanship, discounting and promotional activity, omnichannel approach and sales experiences, and production facilities that set it apart from the other segments of the handbag industry.

Asserting that “a relevant antitrust market can be defined solely based on qualitative evidence regarding market characteristics,” the FTC devotes just a single paragraph of its complaint to the hypothetical monopolist test, which was a mainstay of market definition under the old merger guidelines. The FTC notes that a relevant product market is properly drawn if a “single firm . . . seeking to maximize profits controlled all sellers of a set of products or services and likely would undertake a small but significant and non-transitory increase in price or other worsening of terms” (“SSNIPT”). (The “or other worsening of terms” language is new.) The FTC summarily states that a “hypothetical monopolist of accessible luxury handbags likely would undertake a SSNIPT on consumers” and could do so profitably. This is because the FTC states that consumers would not switch to mass-market or true luxury handbags “in sufficient volumes to render the price increase unprofitable.”

Market Concentration
Referencing the Herfindahl-Hirschman index (the “HHI”) measure of market concentration, the FTC argues that the proposed acquisition will both (1) create a firm with a market share over 30 percent and increase the HHI by more than 100 points and (2) is likely to create or enhance market power as the post-merger HHI exceeds 1800 and increases the HHI by more than 100 points. While redacting the purported combined Tapestry/Capri market share, the FTC argues that Tapestry’s post-acquisition market share of the “accessible luxury” handbag market would be “considerably more than 30 percent.”

History of Serial Acquisitions
Consistent with Guideline 8 of the 2023 Merger Guidelines, the FTC argues that Tapestry has engaged in an “anticompetitive pattern and strategy of acquisition in the accessible luxury market” with plans to continue this strategy as part of its proposed acquisition of Capri. Consistent with Guideline 7 of the 2023 Merger Guidelines, the FTC notes that over the last decade, Tapestry has already consolidated Coach, Kate Spade and Stuart Weitzman and that Capri has consolidated Michael Kors, Versace and Jimmy Choo. As a result, the FTC argues that Tapestry will become an “accessible luxury handbag powerhouse” that will enable it to continue to acquire rivals and entrench its position (consistent with Guideline 6 of the 2023 Merger Guidelines).

Significance

New Versus Old Merger Guidelines
One way to measure the effect of the new merger guidelines is to look at what would have happened but for their release. When the 2023 Merger Guidelines were issued, the consensus was that over time they could lead the government to challenge certain deals that likely would not have been subjected to agency action in the past. The Tapestry-Capri challenge is one of the first data points that could potentially be used to test a hypothesis about the effect of the new guidelines. Redactions in the complaint prevent a thorough analysis of whether this complaint would have also been brought under the old guidelines, but the exercise in comparison is nevertheless informative.

Both the old and the new merger guidelines describe the potential for competitive harm—and thus the potential for a merger challenge—where a merger would lead to a loss of substantial head-to-head competition. (The 2023 Merger Guidelines state that this “can demonstrate that a merger threatens competitive harm independent from an analysis of market shares.”) While

the loss of substantial head-to-head competition could very well have supported a challenge under the old guidelines, it is fair to say that it is unlikely that a complaint would have been brought on that ground alone. As in the current complaint, allegations about the loss of head-to-head competition would likely have been accompanied by allegations about an increase in market concentration.

This leads us to the only theory of harm in the complaint that requires defining a market. This is notable because market definition has long been the lynchpin of merger analysis and often is the most important point of contention in merger challenges—a point at which cases are won or lost. In this case, while market definition is important, it is not central to the FTC's case (assuming the court agrees that the other theories of competitive harm are viable).

Both the old and new guidelines indicate that a merger would violate the law if it increases market concentration above a certain threshold (though the threshold in the new guidelines is appreciably lower). In order to measure market concentration, one must define a relevant market. Both the old and new guidelines focus on the "hypothetical monopolist test" (the "HMT") as a tool to define a market. Evidence of substantial head-to-head competition is also relevant to the task in both sets of guidelines. The new guidelines, however, also state that, under *Brown Shoe Co.* v. *United States*, a "relevant market can be identified from evidence on observed market characteristics ("practical indicia"), such as industry or public recognition . . . , the product's peculiar characteristics and uses, unique production facilities, distinct customers, distinct prices, sensitivity to price changes, and specialized vendors." In the old guidelines, these factors were relevant, but mainly as inputs into the HMT. In the new guidelines, they serve as a standalone method for market definition.

To support its purported "accessible luxury" handbag market, in the Tapestry complaint, the FTC relies mainly on allegations about head-to-head competition and practical indicia, but it does also allege, albeit in a fairly conclusory way, that the market is supported by the HMT. It is therefore unclear whether, but for the new merger guidelines, the FTC would have found a different relevant market and thus declined to challenge this merger. Put another way: Would this FTC have found the same relevant market using the *old* merger guidelines? Perhaps. Would a *different* FTC have found a different relevant market using the new guidelines? Perhaps.

Assuming the market definition is proper (which is highly contestable), Tapestry's acquisition of Capri meets the threshold of presumptive illegality in the new guidelines, according to the complaint. However, based on the complaint, one cannot determine whether the higher threshold in the old guidelines would have been met because the market shares relevant to the calculation are redacted. Without knowing these numbers, it is difficult to say whether the old guidelines would have supported a challenge.

The ensuing litigation may shed more light on the question of whether or not this challenge, centered as it is in the new guidelines, would also likely have been brought under the old guidelines. Perhaps more importantly, though, this litigation may reveal at least how one federal court views the 2023 Merger Guidelines as a statement of merger law. In any event, it will likely take several years and a number of litigated merger challenges to get a real sense of whether the 2023 Merger Guidelines reflect the current state of merger law as interpreted by the courts or whether they are instead a normative set of policy preferences.

For the full text of our memorandum, please see:

- https://www.paulweiss.com/media/3984717/new_merger_guidelines_feature_prominently_in_ftc_handbag_merger_challenge.pdf

11. DOJ and FTC Continue to Focus on Serial Acquisitions and Roll-Ups

On May 23, 2024, the Antitrust Division of the DOJ and the FTC announced that they are launching an inquiry "to identify sectors of the economy being impacted by serial acquisitions" and issued a Request for Information for Public Comment on Corporate Consolidation Through Serial Acquisitions and Roll-Up Strategies (the "RFI"). According to the RFI, "serial acquisitions involve the same firm consolidating a fragmented market through a number of acquisitions, typically of many relatively small companies."

Put another way, “when serial acquisitions occur, a company becomes larger, and potentially dominant, by buying several smaller firms in the same or related business sectors or industries.”

The agencies issued the RFI “to identify serial acquisitions and roll-up strategies throughout the economy that have led to consolidation that has harmed competition” by impacting “quality, prices, and working conditions.” The agencies say that “once these serial acquisition strategies are identified,” the agencies “are committed to using the full scope of their statutory authorities to protect free and fair competition and prevent undue consolidation.”

In connection with the issuance of the RFIs, the FTC held an open meeting at which FTC staff gave a presentation. According to the presentation, there is concern about companies expanding through “successive” small acquisitions which have the cumulative effect of harming competition. Though the RFI is broad, staff are particularly interested in roll-up acquisitions in the health care industry, in the use of roll-up strategies by private equity funds, and in how roll-up acquisitions affect rural markets. As FTC staff explained, part of the motivation for the RFI is that quite often the acquisitions in a roll-up strategy fall below the notification thresholds under the Hart-Scott-Rodino Antitrust Improvements Act of 1976 and are not reported. Yet, according to one FTC official, a “series of relatively small acquisitions can have the same impact on competition as one large one, allowing one firm to eliminate competition and amass significant control over products and services without review by the antitrust agencies.”

The RFI calls for information regarding the following topics “in any sector or industry in the U.S. economy, including, but not limited, to housing, agriculture, defense, cybersecurity, distribution, construction, aftermarket/repair, and professional services markets”:

- examples of serial acquisitions;
- effects of serial acquisitions on competition within an industry, including “any actual or attempted coordination or collusion between competitors” after the serial acquisitions;
- effects of serial acquisitions on customers, workers, actual or potential competitors, and suppliers;
- identification of “serial acquisition business practices,” where acquirers have engaged in conduct such as predatory pricing, exclusive dealing, conditional dealing, tying, price discrimination, raising rivals’ costs, “using actual or threated litigation to drive parties to agree to mergers and/or to drive down acquisition costs,” or “any other conduct that has the intent or effect of lessening competition”;
- the claimed business goals and objectives of the serial acquisition strategy and whether these goals and objectives have been realized post-transaction; and
- if the serial acquisitions were executed by a private equity firm, the role the private equity investor(s) played in evaluating or executing potential acquisitions and in managing the businesses afterwards.

The RFI invites submissions from “consumers, workers, businesses, advocacy organizations, professional and trade associations, local, state, and federal elected officials, and others.” The agencies also invite “comments from academics and other experts with knowledge of the operation of specific industries and business sectors as well as the effects of serial acquisitions more generally.” Comments are due by July 22, 2024.

For the full text of our memorandum, please see:

- https://www.paulweiss.com/media/3984815/doj_and_ftc_continue_to_focus_on_serial_acquisitions_and_roll_ups.pdf

For the Antitrust Division of the DOJ and FTC's Request for Information, please see:

- https://www.ftc.gov/system/files/ftc_gov/pdf/Serial%20Acquisition%20RFI_5.22.24.pdf

12. Hospitals Defeat FTC Merger Injunction Request With a Version of the "Failing Firm" Defense

In a recent hospital merger challenge brought by the FTC, defendants successfully asserted a version of the "failing firm" defense to avoid a preliminary injunction. Even though the FTC lost, the court's evaluation of the defense was generally in line with the Merger Guidelines. However, the court's reasoning suggests that in some circumstances defendants may assert the failing firm defense successfully without having to adhere rigidly to each and every purported element stated in the guidelines. Here, the court appears to have allowed the defense where the "failing firm" is apparently undergoing an out-of-court reorganization involving the sale or shuttering of some facilities.

On June 5, 2024, Judge Kenneth D. Bell of the United States District Court for the Western District of North Carolina denied the request of the FTC for a preliminary injunction preventing Novant Health, Inc. from acquiring the Lake Norman Regional Medical Center and Davis Regional Psychiatric Hospital from Community Health Systems, Inc. while a related FTC administrative proceeding is pending. Both of the facilities to be acquired are located within approximately 17 miles of each other in an area north of Charlotte, and the Lake Norman hospital is approximately 12 miles from a Novant hospital.

In reaching this decision, the court found that the FTC met its initial burden under the applicable standard of demonstrating a likelihood of success in proving a prima facie case that "the effect of the acquisition may be substantially to lessen competition, or to tend to create a monopoly" in violation of section 7 of the Clayton Act. But the court went on to find that the defendants met their burden of rebutting the prima facie case by demonstrating that there are "bona fide economic difficulties which are so existential as to establish that the entity being acquired will no longer be a viable competitor in the absence of the proposed transaction" and that the equities favored denial of the FTC's injunction request.

The FTC filed a notice of appeal. Judge Bell declined to issue an injunction pending appeal but extended an earlier temporary restraining order until June 21 to allow time for the FTC to move the Fourth Circuit for an injunction.

The court's decision is significant because it is an example of a "rare case" where a "failing firm" defense was successful in defeating a request for a merger injunction. The decision is also notable because it suggests that some courts may have a slightly less rigid view of the circumstances in which a defense is appropriate.

For the full text of our memorandum, please see:

- https://www.paulweiss.com/media/3984888/hospitals_defeat_ftc_merger_injunction_request_with_a_version_of_the_-failing_firm-_defense.pdf

13. Seventh Circuit Pans Pursuit of Mootness Fees, Urges Further Judicial Scrutiny of "Problematic" Merger Objection Cases

On April 15, 2024, the Seventh Circuit issued an opinion written by Judge Frank H. Easterbrook in *Alcarez* v. *Akorn, Inc.* ("*Akorn*"), criticizing the plaintiffs' bar for pursuing "mootness fees" in merger objection cases, and outlining potential mechanisms by which courts can scrutinize mootness fees even following the voluntary dismissal of such cases.

Background

The announcement of a public company merger almost inevitably invites dozens of shareholder litigations challenging the target company's disclosures under Section 14(a) of the Exchange Act, or challenging the board's approval of the deal as a breach of fiduciary duty. Following the Delaware Court of Chancery's decision in *In re Trulia, Inc. Stockholder Litigation*, these cases are rarely litigated; instead, companies typically resolve the actions by issuing supplemental disclosures and then agreeing to pay a "mootness fee" to plaintiffs' counsel. Plaintiffs' firms often bring these cases as individual actions rather than class actions to

evade the requirements of the Private Securities Litigation Reform Act of 1995 (the "PSLRA"). Many other plaintiffs' firms bring their allegations in the form of demand letters, to avoid having to file a case and risk judicial scrutiny altogether.

In recent years, federal courts have criticized merger objection cases as "no better than a racket" that "must end," and have in some cases rejected plaintiffs' firms' efforts to extract attorneys' fees from companies after they have issued supplemental disclosures. The Seventh Circuit's decision in *Akorn* highlights tools that courts can use to apply further scrutiny to mootness fees in such cases.

Procedural History

The *Akorn* case involved attorney and Akorn shareholder Theodore Frank, who was concerned about the rampant proliferation of merger objection lawsuits and mootness fees taking money from corporate treasuries.

In 2017, after Akorn announced its proposed merger with Fresenius Kabi AG, six Akorn shareholders filed lawsuits challenging the adequacy of the disclosures. Five of these were filed as class actions, which many plaintiffs' firms have stopped doing. Akorn subsequently revised its proxy statement to include additional disclosures, and plaintiffs voluntarily dismissed their suits, asserting that the additional disclosures mooted their complaints. Counsel informed the court that their claim to attorneys' fees and costs had been resolved by Akorn's payment of $322,500 in "mootness fees."

Frank moved to intervene, and sought to require plaintiffs' counsel to disgorge the mootness fees back to Akorn and to enjoin them from filing future "strike suits," pursued "for the sole purpose of obtaining fees for the plaintiffs' counsel." The district court denied Frank's motion, finding that he had not identified an interest in the case justifying his intervention. However, mindful of the Seventh Circuit's previous admonition in *In re Walgreen Co. Stockholder Litigation* that disclosure litigation is a "racket" that "must end," and "concerned with the plaintiffs' apparent success in evading the requirements of Rule 23," the district court invited Frank to file a motion for reconsideration. Although the district court again denied his motion to intervene, it determined to "exercise its inherent powers to police potential abuse of the judicial process—and abuse of the class mechanism in particular—and require plaintiffs' counsel to demonstrate" that the disclosures they sought corrected a "plainly material" misrepresentation or omission.

The district court ultimately held that the disclosures were not plainly material and instead "were worthless to the shareholders." In an "exercise [of] its inherent authority to rectify the injustice that occurred," the district court abrogated the settlement agreements and ordered plaintiffs' counsel to return the mootness fees to Akorn. Plaintiffs' counsel appealed.

The Seventh Circuit's Decision

On appeal, plaintiffs challenged the district court's assertion of its "inherent authority" to review the mootness fees after they had voluntarily dismissed their cases.

The Seventh Circuit agreed that the district court had erred in reopening the cases without a motion under Rule 60(b). Nevertheless, it noted that the PSLRA, "affect[s] the proper treatment of suits filed in quest of mootness fees." Specifically, the PSLRA dictates that upon "final adjudication" of a securities class action brought under the Exchange Act, courts must "include in the record specific findings" as to whether the parties complied with Rule 11(b) of the Federal Rules of Civil Procedure—including that the lawsuit was not filed "for any improper purpose" and the claims are supported by the law.

Applying the PSLRA to the dispute at hand, the Seventh Circuit reasoned that the voluntary dismissal of each suit was a "final adjudication of the action," and therefore, the district court was obligated to "determine whether each suit was proper" under Rule 11(b) "at the moment it was filed." Despite the district court's invocation of its "inherent authority" rather than the PSLRA and Rule 11(b), the Seventh Circuit "agree[d] with the district judge's analysis," which in substance had found that the complaints violated Rule 11(b). The Seventh Circuit also noted that Rule 11(c)(4) "gives the district judge discretion over the choice of sanction," and therefore the court was "entitled to direct counsel who should not have sued at all to surrender the money they extracted from Akorn."

The Seventh Circuit thus remanded with instructions to treat Frank as an intervenor, allow him to move under Rule 60(b) to reopen the cases, and determine the appropriate relief, if any, under the PSLRA and Rule 11(b).

Implications

The Seventh Circuit's opinion once again takes issue with "problematic" merger objection cases and the "racket" mootness fee practices by the plaintiffs' bar. The decision sends a strong message that courts should consider being more proactive in policing these suits.

For the full text of our memorandum, please see:

- https://www.paulweiss.com/media/3984648/seventh_circuit_pans_pursuit_of_mootness_fees-_urges_further_judicial_scrutiny_of_-problematic-_merger_objection_cases.pdf

For the Seventh Circuit's opinion in *Akorn*, please see:

- https://media.ca7.uscourts.gov/cgi-bin/OpinionsWeb/processWebInputExternal.pl?Submit=Display&Path=Y2024/D04-15/C:19-2408:J:Easterbrook:aut:T:fnOp:N:3196368:S:0

* * *

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:

Matthew W. Abbott
+1-212-373-3402
mabbott@paulweiss.com

Andre G. Bouchard
+1-302-655-4413
abouchard@paulweiss.com

Christopher J. Cummings
+1-212-373-3434
ccummings@paulweiss.com

Adam M. Givertz
+1-212-373-3224
agivertz@paulweiss.com

Ian M. Hazlett
+1-212-373-2562
ihazlett@paulweiss.com

Christian G. Kurtz
+1-416-504-0524
ckurtz@paulweiss.com

Audra J. Soloway
+1-212-373-3289
asoloway@paulweiss.com

Stephen C. Centa
+1-416-504-0527
scenta@paulweiss.com

Rosita Lee
+1-212-373-3564
rlee@paulweiss.com

Andrea Quek
+1-416-504-0535
aquek@paulweiss.com

Associates Robin Chang, Daniel J. Korman and David A.P. Marshall, and Summer Associate Clifford Y.H. Chuang contributed to this Client Memorandum.