Fried Frank

M&A/PE Quarterly

Fried Frank's quarterly roundup of key M&A/PE developments

Third Ruling in McDonald's *Indicates Unlikelihood of Success of* Caremark *Claims Against Officers Unless the Board Also Breached* Caremark *Duties Or Was Not Independent and Disinterested*

Although the Delaware Court of Chancery early this year, in its first pleading-stage decision issued in the *McDonald's* case, extended *Caremark* duties to corporate officers, the court's most recent (and final) decision in the case indicates the unlikelihood of success for plaintiff-stockholders asserting *Caremark* claims against officers unless *the board* also breached its *Caremark* duties or otherwise was not independent and disinterested with respect to the alleged misconduct that was the subject of the claims. In the court's third pleading-stage decision in *McDonald's* (issued March 1, 2023) (the "Third Decision"), the court dismissed *Caremark* claims against David Fairhurst, the former head of human resources of McDonald's Corp., that the court previously had found led to a reasonable inference that Fairhurst had violated his *Caremark* duties. The court has now dismissed the claims on the grounds that demand on the McDonald's board to bring the claims would not have been futile, given that the court (also on March 1) had dismissed the *Caremark* claims against the directors and they therefore did not face a substantial likelihood of liability that would have supported demand futility.

Background. Certain stockholders of McDonald's brought claims against Fairhurst, as well as McDonald's former CEO and the McDonald's directors, asserting *Caremark* claims in connection with a sexual harassment problem at the company that had led to numerous EEOC claims and fines, employee walkouts and lawsuits, and inquiries from a U.S. Senator.

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The plaintiffs alleged that Fairhurst and the CEO had fostered an extreme party atmosphere at the company, with excessive drinking and sexual harassment; that Fairhurst himself had engaged in sexual harassment of employees; that the CEO had engaged in prohibited relationships with employees; and that the board had not responded in a timely or sufficient manner to red flags that the problem existed. The CEO settled the claims against him, agreeing to return the $105 million severance he had received when he was terminated without cause.

In the first decision in the case, issued in January 2023 (the "First Decision"), the court rejected dismissal of the claims against Fairhurst, holding, for the first time, that *Caremark* duties apply not only to directors but also to officers, and holding that the plaintiffs had pled valid claims that Fairhurst had breached his *Caremark* duties. In the second pleading-stage decision in the case, issued March 1, 2023 (the "Second Decision"), the court dismissed the claims against the directors, finding that once they knew of the problem they took action (albeit arguably deficient action) to address it. In the Second Decision, the court, while broadening the commonly understood parameters for applicability of *Caremark*, emphasized that bad faith is required for liability under *Caremark*, which creates a high bar for success by plaintiffs. In the Third Decision, as noted, the court dismissed the claims against Fairhurst—reasoning that, because in the Second Decision the claims against the directors were dismissed, there was now no basis on which the plaintiffs could plead demand futility.

Demand Futility. *Caremark* claims are derivative claims—that is, they are claims asserting corporate wrongdoing that are brought by plaintiff-stockholders on behalf of the corporation. Given that, as a general matter, shareholder derivative suits represent a fundamental encroachment on the managerial authority and discretion of a company's board, shareholder-plaintiffs bringing derivative claims must either make a demand on the board to bring the claims or establish that such a demand would have been futile because a majority of the directors in place at the time the demand would have been made could not have exercised independent and disinterested business judgment in responding to the demand. Under the *Zuckerberg* test for demand futility established by the Delaware Supreme Court, one of the bases on which directors can be found not capable of independent judgment with respect to such a demand is where the directors themselves would face a substantial likelihood of liability on the claims that are the subject of the demand. The other bases for demand futility under the *Zuckerberg* test are that the director received a material personal benefit from the alleged misconduct; or that the director lacks independence from someone who received a material personal benefit from the alleged misconduct or who faces a substantial likelihood of liability on the claims that are the subject of the demand.

In *McDonald's*, the plaintiffs had not made a demand on the board and argued that demand would have been futile because nine of the directors faced a substantial risk of liability for the claims that the plaintiffs had asserted against them for failure to oversee the sexual harassment problem at the company, and that those claims were so intertwined with the claims against Fairhurst that the directors could not have acted in a disinterested manner in responding to the demand to bring litigation against Fairhurst. The court explained that, as the court in the Second Decision had dismissed the claims against the directors, they no longer faced any likelihood of liability. Therefore, the court wrote, "[f]or purposes of this case, the road to establishing demand futility that the plaintiffs sought to travel is closed." The claims were dismissed with prejudice but (as required under Court of Chancery Rule 15(aaa)) against the named plaintiffs only.

Impact of the *McDonald's* decisions on *Caremark* cases.

- **We expect there will be a further increase in *Caremark* cases.** *Caremark* cases

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already have proliferated in the past few years, and the *McDonald's* decisions are likely to accelerate that trend. First, the First Decision established that *Caremark* duties of oversight apply not only to directors but also to officers. Second, the Second Decision established that *Caremark* duties apply not only to a what the court has referred to as "mission critical risks" but, depending on the facts, may apply to other key risks even if not rising to the level of mission-critical. Third, the Second Decision indicated that sexual harassment (and presumably similar issues, such as, say, discrimination) that previously have been considered primarily as giving rise to employment-related claims rather than fiduciary duty claims are mission critical risks for most companies. Indeed, the court stated that "maintaining workplace safety…[and] tak[ing] care of the corporation's workers" are mission-critical, as employees do the work that creates the company's value. Fourth, we note that, in *McDonald's*, the court did not focus at all on the damage to the company that resulted from the sexual harassment problem, while in other cases in which the court has found potential *Caremark* liability the corporate catastrophes that resulted from the alleged lack of oversight had led to loss of human lives and safety, as well as very significant financial and reputational damage (usually creating an existential kind of crisis threatening the company's very survival).

- **When claims are brought, they are likely to be brought against both the board and officers.** The court's First Decision, establishing that *Caremark* duties apply to officers, is consistent with a general trend over the last several years of court decisions outside the *Caremark* context that have expanded potential liability for corporate officers. The decisions may result in greater focus by officers and directors on the benefits of amending the company's charter to provide for exculpation of liability for officers (as is now permitted under recently amended DGCL Section 102(b)(7)). Notably, however, such exculpation would not apply to *Caremark* claims against officers—as, under the new amendment to Section 102(b)(7), the charter cannot be amended to exculpate officers for derivative claims.
- **There will continue to be, generally, a high bar to success for plaintiffs on *Caremark* claims.** As the court emphasized in the First and Second Decisions, a director or officer breaches *Caremark* duties only if the director or officer acted in bad faith (in other words, that the failure of oversight was knowing and intentional). A failure of oversight due to negligence or stupidity does not support a *Caremark* claim. In addition, as the Third Decision underscores, *Caremark* claims, being derivative, are subject to all of the usual defenses to derivative claims, including the demand futility defense.
- ***Caremark* claims brought by stockholders against *officers* (even if meritorious) are unlikely to succeed if the *board* acted properly.** As illustrated by the Third Decision, *Caremark* claims brought by stockholders against officers are likely to be dismissed at the pleading stage, based on the demand futility defense, if the *Caremark* claims against the directors are dismissed. Thus, unless the directors appear to have breached their *Caremark* duties, or the directors are otherwise not independent and disinterested with respect to the misconduct at issue, *Caremark* claims against the officers probably will be dismissed at the pleading stage, even if the officers appear to have breached their *Caremark* duties.

  After such a dismissal, the officer (like Fairhurst currently) would face potential liability only if (i) the board (on its own, or after receiving a stockholder litigation demand) decides to bring a claim against the officer; (ii) other stockholders bring suit, asserting a different basis for demand futility than the original plaintiffs asserted; or (iii) the original stockholder-plaintiffs are successful in having the court reopen the case (under Court of Chancery Rule 30(b)) based on newly discovered evidence supporting the basis for demand futility that they had asserted and the court had rejected (for example, in the *McDonald's* case, if there were to be newly discovered evidence indicating that the directors faced a substantial likelihood of liability). (We note that, on March 21, 2023, the Court of Chancery, in *Lebanon Cty. Empl. Rtmt. Fund v. Collis*, rejected such a motion to reopen the *Caremark* case against officers and directors of Amerisource-Bergen Corporation, finding that the newly discovered evidence the plaintiffs offered—which was that the U.S. Department of Justice filed a complaint against the officers and directors—did not meet the requirements of Rule 30(b), as, first, it was what the court called "new evidence" rather than "*newly discovered* evidence," and, second, it was not sufficiently material that it would probably change the court's previous outcome.)

Court of Chancery Rejects Plaintiff's "Biking Buddies Theory" for Director Non-Independence—Orbit/FR

In *In re Orbit/FR, Inc. Stockholders Litigation* (Jan. 24, 2023), the Delaware Court of Chancery, at the pleading stage of litigation, dismissed claims against Douglas Merrill, a former director of Orbit/FR, Inc. ("Orbit"), who had served on the special committee that negotiated a sale of Orbit to its controller, Microwave Vision, S.A. ("Micro"). The plaintiff alleged that Merrill had favored the merger due to his close personal relationship with another former Orbit director, Per Iversen,

who had dual fiduciary duties to Orbit and Micro. The court found that the alleged relationship of the two directors, based primarily on their having been neighbors and regular "biking buddies" years before the merger, was not sufficiently close to support an inference that Merrill had acted disloyally to facilitate Iversen's interest in furthering the interests of Micro.

In this most recent decision in the case, Vice Chancellor Glasscock dismissed the claims against Merrill. In an earlier decision, issued January 9, 2023, the Vice Chancellor had rejected dismissal of the claims against Micro, Iverson, Micro's CEO (who was also Orbit's Chairman of the Board), and another executive of Micro—and the case will now proceed against those defendants.

Key Point

- **A years-ago routine of shared bike rides with a friend, and being nominated by the friend as a director, were not sufficient support for an inference that the director acted disloyally to further the friend's interests.** A director's close friendship with a person who has a personal interest in a merger can call into question whether the former acted in the latter's interests rather than, as the duty of loyalty requires, in the interests of the corporation and its stockholders. However, particularized facts must be alleged indicating that the friendship was sufficiently close to support a reasonable inference that the director may have ignored the duty of loyalty to advance the friend's interests.

Background. Micro acquired a controlling interest in Orbit in 2008. Micro's CEO then served as Chairman of Orbit's board; Iverson, who was an executive at Micro, served as Orbit's CEO-director; and, at Iversen's request, Merrill served as a director of Orbit until 2012, and then in 2016 (two months before Micro made its proposal to acquire Orbit in a freeze-out merger) he was re-recruited back to the board. Allegedly, Micro operated Orbit unfairly to the detriment of the minority stockholders.

In 2015, AB Value Partners, L.P. ("Partners"), which owned 71.6% of Orbit's minority shares, rejected an offer from Micro to acquire its Orbit shares (at prices that, notwithstanding Orbit's increased gross profits, were below what Micro had paid for its controlling stake). In mid-2016, Micro submitted an offer to acquire Orbit, conditioned on recommendation by an Orbit independent committee and a majority-of-the-minority shares. The board formed a special committee comprised of Merrill and another director. The special committee retained CBIZ Valuation Group as its financial advisor. CBIZ ultimately declined to provide a fairness opinion. In 2017, Partners rejected two further offers by Micro to purchase its Orbit shares, in response to which Micro eliminated the condition in its offer for approval by a majority-of-the-minority shares. The committee then retained another financial advisor, Stout Risus Ross, which determined that Orbit's minority shares were worth $0.22 per share (although they had traded above $2.82 per share since January 1, 2016). In February 2018, Micro and the special committee agreed on a price of $3.30 per share. The special committee then requested that the board approve a payment to Stout so that it could begin its fairness opinion analysis. At the end of March 2018, Stout issued a fairness opinion and the special committee recommended, and the board approved, the merger. Micro adopted the merger agreement by written consent. The merger closed in early April 2018.

A former stockholder brought suit against Micro, Iverson, and other Micro executives, alleging that the merger was unfair. The claims withstood motions to dismiss, after which a settlement agreement was reached providing for cash consideration to be paid to Orbit's minority stockholders. However, Partners (which held a majority of the minority shares) objected to the settlement. The court permitted Partners to become the lead plaintiff and continue the litigation. Vice Chancellor Glasscock dismissed the claims against Merrill, and the case will proceed against the other defendants.

Discussion

The plaintiff claimed that Merrill breached his duty of loyalty by favoring the merger due to his close relationship with Iverson. The plaintiff did not claim that Merrill had a personal interest in the merger, but that *Iversen* had divided loyalties as a fiduciary of both Orbit and Micro—and that Merrill, based on his allegedly "close and meaningful" personal relationship with Iversen, acted to further Iversen's desire to benefit his employer, Micro, by supporting Micro's acquisition of Orbit in a process and at a price that were unfair to Orbit's minority stockholders. The court found, however, that the alleged facts, even when viewed (as required at the pleading stage) in the light most favorable to the plaintiff, "[did] not imply that Merrill allowed his fiduciary duties to be overborne by a personal loyalty to Iversen or Micro."

The plaintiff contended that the following factors established a sufficiently strong relationship between Merrill and Iversen as to suggest that Merrill acted to further Iversen's interests: First, in 2004, Merrill and Iversen became friendly when they lived two houses apart, and they "bonded" over their shared interest in mountain biking, engaging in a regular routine of Saturday morning mountain biking rides during which they discussed business, with Merrill providing advice to Iversen. Their wives and children were also friendly with each other. Second, Iversen recommended that Merrill serve on Orbit's board (the only public board on which Merrill served).

The court rejected the plaintiff's contention that a duty of loyalty breach could be reasonably inferred based on the closeness of the relationship between Merrill and Iversen. The court acknowledged that "sufficiently close relationships between a conflicted party and a fiduciary may call into question the loyalty of the fiduciary." In this case, however, the court stated, "the allegation is simply that, years before the transaction, Iversen and Merrill enjoyed bicycle rides together, ending in 2005." Vice Chancellor Glasscock wrote: "This (together with Iversen suggesting Merrill for a directorship) is the sole allegation of a relationship between the two men. Even given the Plaintiff-friendly inferences inherent in a motion to dismiss, I cannot find it reasonably conceivable that Merrill would 1) conclude that Iversen was loyal to Micro and therefore wished to consummate a transaction unfair to Orbit, and 2) that Merrill accordingly breached his duty of loyalty to Orbit by facilitating Iversen's plot to consummate this unfair transaction, based [on] the friendship engendered by a long-abandoned exercise routine."

The court rejected the plaintiff's contention that Merrill's actions during the sale process supported an inference that Merrill was acting to facilitate Iversen's interest in an unfair transaction. The plaintiff alleged that Merrill had provided back-channel communications to Iversen and Orbit's CEO about CBIZ's concerns regarding Orbit's management projections. (Iversen allegedly tried to hide the communications by saving Merrill's cell phone number under the alias "Hugo Rodriguez.") The plaintiff also alleged that Merrill had provided "bad data" to both CBIZ and Stout. Also, the plaintiff noted, Merrill had allowed Stout to render its fairness opinion *after* the special committee had already agreed the deal price. The court stated that these allegations, standing alone, were insufficient to support an inference that Merrill's actions amounted to bad faith. The allegations "only assume[d] importance given the allegation that Merrill was so close to Iversen that he lacked independence from Iversen's alleged scheme to cause Micro to underpay for Orbit." The Vice Chancellor wrote: "Because I find the 'biking buddies' theory insufficient to support an inference of lack of independence from Iversen on the part of Merrill, the additional allegations, at most, indicate a lack of care (and not loyalty) on Merrill's part in the conduct of the Special Committee."

Practice Points

- **Judicial determination of director independence is highly facts-dependent.** Allegations merely that a director is friends with, travels in the same social circles as, or has had past business relationships with the proponent of a transaction generally are not sufficient to overcome the presumption of a director's independence. A plaintiff seeking to show that a director was not independent must meet a materiality standard, under which the court must conclude that the director's ties to the person whose proposal or actions the director is evaluating are sufficiently substantial that the director cannot objectively fulfill his or her fiduciary duties.
- **It is well-established that a director's independence is not compromised simply by virtue of having been nominated to a board by an interested person.** That said, we note that, in another recent case, *Goldstein v. Denner* (May 2022), the court suggested that it may view skeptically the independence of a director who was placed on the board under the auspices of an activist investor or other investor who may be viewed as a "short term investor" or a "repeat player." Such investors, the court indicated, may create an expectation for a director of "future benefits" from the investor in the form of board seats on other portfolio companies. Thus, an investor who places directors on boards should weigh the advantages and disadvantages of "serial" appointments before naming the same persons to numerous board seats.
- **Directors should establish a record of their independence.** In all cases, directors should ask questions and seek information (which may be recorded in the board minutes) that evidence that the director's consideration is focused on the best interests of the company and its stockholders (rather than the director's self-interest or the interest of any other director or other person). Certainly, directors and officers should not engage in "back-channel" communications during a sale process; should seek to ensure that accurate data is provided to the board's financial advisors; and should obtain a fairness opinion before, not after, the board agrees on a deal price.

First Contested Director Elections Under New Universal Proxy Card Rules Highlight Impact of Advance Notice Bylaws, Targeting of Individual Directors, and Influence of Proxy Firms

There has been much speculation about how the new SEC rules requiring universal proxy cards for election of directors, which became effective in September 2022, will affect activists' campaigns to obtain board seats. While it is too early in

the 2023 proxy season to gauge the impact of the new rules, we discuss below the new rules, their interrelationship with advance notice bylaws, the related policies issued by the major proxy firms, and how the first contested director elections since the rules have been in effect have unfolded.

New Exchange Act Rule 14a-19. Prior to the enactment of Rule 14-a-19 (and related updated and amended rules), stockholders voting *in person* in an election for directors could choose among the company's and a dissident stockholder's respective nominees, but stockholders voting *by proxy* were limited to voting either for the company's nominees listed on the company's proxy card or, alternatively, for the dissenting stockholder's nominees listed on the dissenter's proxy card. Under the new rules, both the company and any dissident stockholder nominating director candidates must list, on a "universal proxy card," *all* of the persons properly nominated (*i.e.*, whether nominated by the company or by a dissident) for election at the next annual meeting. The new rules do *not* apply to registered investment companies, business development companies, foreign private issuers, or consent solicitations.

Format of a universal proxy card. The precise formatting and design of the universal proxy card is not prescribed, except that the card must present the nominees in a clear, neutral manner; clearly distinguish among the company's nominees, a dissident stockholder's nominees, and any proxy access nominees; within each group of nominees, list the names in alphabetical order by last name; and use the same font type, style and size for each nominee's name. In addition, the card must provide a means for stockholders to grant authority to vote for nominees set forth on the card; "prominently disclose" the maximum number of nominees for which authority to vote can be granted, as well as the treatment and effect of a proxy card reflecting overvoting, undervoting or no-voting (*i.e.*, a card that submits votes for fewer or greater than the number of director seats up for election, or that submits no votes or withhold votes); and provide certain additional information with respect to voting mechanics.

Proxy statements. A soliciting stockholder must file its definitive proxy statement by the later of (x) 25 calendar days before the stockholder meeting and (y) 5 calendar days after the company files its definitive proxy statement. If the deadline is missed, the company can disseminate a new proxy card that lists only the company's nominees. A company's proxy statement must state the deadline by which a dissenting stockholder must notify the company that it intends to nominate director candidates to be included on a universal proxy card at the next annual meeting. The company proxy statement also must disclose how the company will treat proxies granted in favor of a dissident's nominees if the dissident abandons its solicitation or fails to comply with the proxy rules. In a contested election, the company's proxy statement must disclose that a stockholder has made nominations; and each party must refer stockholders to the other's proxy statement for information about the other's nominees and must note that the other's proxy statement can be accessed free of charge on the SEC's website.

Solicitation requirement. A dissident stockholder making nominations must solicit at least 67% of the shares with voting power to elect directors. The stockholder's nomination notice and proxy statement (or form of proxy) must state that the stockholder intends to make such a solicitation. These requirements are intended to prevent dissenting stockholders from capitalizing on the inclusion of their nominees on the company's universal proxy card without having to undertake their own meaningful solicitation efforts. Failure to meet the solicitation threshold would constitute a violation of Rule 14a-19, thus exposing the dissident to liability for violating the proxy rules. In addition, the dissident would be subject to potential liability under Rule 14a-9 if its statements in the proxy statement (or form of proxy) or nomination notice, regarding its intention to meet the solicitation threshold, were false. According to the SEC's adopting release, a dissident can solicit stockholders under the "notice and access" method of posting the proxy materials to a website and mailing a notice that the proxy materials are available on the internet (rather than mailing a full proxy statement to stockholders).

Nomination notice deadlines. *In addition* to deadlines imposed under any advance notice requirements in the company's bylaws or other governing documents, a stockholder must notify the company of its intended nominees at least 60 calendar days prior to the anniversary date of the previous year's annual meeting. The company must notify a soliciting stockholder of its nominees at least 50 calendar days prior to the anniversary date of the previous year's annual meeting. If the company or the stockholders makes any changes in the intended nominees, it must promptly notify the other. (Under the new rules, if the company did not hold an annual meeting the previous year, or if the date of the meeting has changed by more than 30 calendar days from the previous year, then: (i) stockholder must provide the notice by the later of (x) 60 calendar days prior to the date of the annual meeting and (y) the tenth calendar day following the date of which the company first publicly announces the date of the annual meeting, and (ii) the company must provide notice no later than 50 calendar date prior to the date of the annual meeting.)

SEC Staff CD&Is. The SEC Staff published Compliance and Disclosure Interpretations (Aug. and Dec. 2022) concerning Rule 14a-19.

- CD&I Question 139.04 clarifies that a dissident must comply with the requirements of *both* Rule 14a-19 and the

company's advance notice bylaws; and that a company need not list on its universal proxy card a dissident's nominees if the company determines that the dissident failed to comply with such requirements.

- CD&I Question 139.05 provides that, if the company determines that the dissident's notice of nomination is invalid based on a failure to comply with such requirements, and the dissident files a lawsuit challenging the determination, the company must disclose in its proxy statement: that it made such a determination; that the dissident brought litigation challenging the determination; a brief description of the basis for the company's determination; and the potential implications if the dissident's nominations ultimately are deemed to be valid. In addition, if a company furnishes proxy cards that do not list the dissident's nominees, and a court decides that the dissident's nominations were validly made, the company must then furnish universal proxy cards listing the dissidents' nominees, discard any cards that were previously furnished, and ensure that stockholders are provided with sufficient time prior to the stockholders meeting to receive the universal proxy cards and cast their votes.
- CD&I Question 139.06 clarifies that a dissident must furnish its own universal proxy card; and must solicit holders of at least 67% of the voting power of shares entitled to vote on the director election contest, and include a representation to that effect in its proxy statement.

Bona fide nominee rule. Historically, under the "bona fide nominee rule" (Rule 14a-4(d)(1)), only persons who consented to being named in the company's proxy statement and to serving as a director could be company nominees, and only persons who consented to being named in a dissident's proxy statement and to serving as a director could be the dissident's nominee. The new rules expand the bona fide nominee rule to include any nominee that has consented to being named in *any* proxy statement for the next stockholder meeting for director elections (instead of being limited to consenting to being named in the proxy statement of the party making their nomination) and to serving as a director.

Short slate rule. The "short slate rule" (Rule 14a-4(d)(4)) is a mechanism by which dissident stockholders soliciting proxies for less than a majority of directors on a board can provide a means by which the stockholders they solicit can vote for some of the company's nominees as well. The short slate rule is no longer necessary for operating companies given that, under the new rules, stockholders can pick and choose among the company's and a dissenter's nominees and the modification (noted above) of the bona fide nominee rule—however, the rule remains in place for entities, such as funds, that are not subject to the universal proxy card requirement.

"Against" and "withhold" votes. Under amended Rule 14a-4(b), if the applicable voting standard (such as majority voting) gives legal effect to votes cast against a nominee, then the proxy card must include "against" and "abstain" voting options (and not a "withhold" option). If the applicable voting standard (such as plurality voting) does *not* give legal effect to votes cast against a nominee, the proxy card may *not* include an option for stockholders to vote "against" any nominee, and instead must provide an option, with respect to each nominee, to "withhold" authority to vote. In these situations, in lieu of providing a "withhold" box next to a nominee's name, an instruction can be provided in bold-face type stating that the stockholder may withhold authority to vote for any nominee by marking a line through the name of the nominee; blank spaces can be designated in which the stockholder may enter the names of nominees with respect to whom it chooses to withhold authority to vote; or any other similar means can be provided for, so long as instructions are provided that state how the stockholder may withhold authority to vote for any nominee.

Advance notice bylaws. The trend has continued of companies setting forth in their advance notice bylaws substantially expanded information and other requirements for director nominations. A few companies have extended the requirements to include the provision of very extensive (and even arguably proprietary or confidential) information about the nominator and its known supporters, but in some cases these have been withdrawn in the face of strong negative stockholder reaction (see the article below on the Masimo Corp.'s advance notice bylaws). Delaware court decisions have emphasized that, generally, stockholders must comply precisely with the technical requirements of advance notice bylaws; but that the courts will apply enhanced scrutiny review to a board's determination that a nomination notice was non-compliant with the bylaws. Thus, a board must act in good faith and equitably in rejecting (even plainly non-compliant) nomination notices.

In Jorgl v. AIM Immunotech (Oct. 28, 2022), the Delaware Court of Chancery denied a dissident stockholder's motion for injunctive relief to require the AIM board to accept the dissident's director nominations and list the nominees on the universal proxy card to be sent to AIM's stockholders in connection with the company's 2022 annual meeting. The court found that, while the dissident purported to have complied with the minimal procedural requirements of Rule 14a-19, the dissident had failed to demonstrate that its director nomination notice complied with the "unambiguous" requirements of AIM's advance notice bylaws (namely, disclosure of the members of the dissident's group, and arrangements and understandings involving the group members). Vice Chancellor Lori Will observed that there are legitimate reasons for a company to require information on arrangements and understandings concerning director nominations, and that such information likely would be material

to stockholders in deciding on which nominees to support. The Vice Chancellor did not reach a conclusion as to the validity of AIM's rejection of the dissident's nominations, however, as there were factual disputes that in any event prevented the court from granting the requested injunctive relief. (See also here the Fried Frank M&A/PE Briefing on the Court of Chancery's *Strategic v. Lee Enterprises* decision (Feb. 14, 2022), *Implications of* Lee *for a Board's Decision to Reject a Nomination Notice That is Not in Compliance with the Advance Notice Bylaw.*)

ISS policy. In an updated FAQs report issued by ISS (Jan. 17, 2023), ISS stated that the universal proxy card rules will not change its approach to proxy contests. The "two-prong framework" it has applied in the past "will remain generally the same," according to the report—namely, first, "Is there a case for change?" and, second, "If so, how much change/which nominees?" The case for a change would need to be established first; but the second prong "will likely demand a greater degree of scrutiny under the UPC [universal proxy card] regime," ISS stated in the report.

Glass Lewis policy. In a statement issued by Glass Lewis (Sept, 22, 2022), Glass Lewis reported that it does not expect its overall approach in evaluating proxy contests to change under the universal proxy card system. For Glass Lewis "to support any dissident nominee in a proxy contest, Glass Lewis still [will] require the activist to make a compelling case for change and to nominate qualified, unconflicted director candidates who seem better suited to address deficiencies or to facilitate a superior outcome for shareholders." In other words, it stated, "the hurdles we believe an activist must clear in order to win board representation will not be lower under a universal proxy card system." Glass Lewis observed that the new system potentially could "make all incumbent directors on a board more vulnerable for replacement, whether they are specifically identified as a targeted director by the activist or not" and it stated that it expects there will "be a greater emphasis on evaluating the respective skills and qualifications of each individual company and dissident nominee, not only for those nominees who are pitted against each other, but also in terms of the board composition as a whole," with "less of a zero-sum proposition and a more holistic approach to assessing director candidates." In one of its recommendation reports issued in connection with a recent contested director election, Glass Lewis stated that, consistent with its past practice, it is "reticent to recommend the removal of incumbent directors…unless certain issues are evident" (such as poor corporate governance oversight).

Other policies and observations. Vanguard issued a statement (Feb. 13, 2023) indicating that its internally managed funds' approach to evaluating contested director elections "remains the same" under the new universal proxy card regime. The fund will "assess the strategic case for change, evaluate the company's approach to governance, and review the skills and qualifications of both the management and dissident director nominees." Vanguard stated further that it believes "that companies should continue to proactively engage with shareholders, making independent directors available for such conversations; provide adequate disclosure of board composition that explains how the board's collective and individual talents and skills align with the current and future needs of the company; and communicate steps the board is taking to measure and enhance its effectiveness, including how it conducts board assessments and ongoing director education and training."

The Conference Board issued a statement (Feb. 5, 2023) positing that "the vast majority of actual or threatened proxy fights [in 2023] will feature opposing candidates with strong industry experience." The Board advises that, "[i]n explaining why they have the right board composition, companies will want to focus not just on filling in a skills matrix, but on explaining how directors add value, including through their [industry] experience…." The Conference Board concludes that "[h]aving recent and relevant industry experience on the board may be a company's best defense in contested director elections."

First Contested Director Elections Under the Universal Proxy Card Regime

The impact of the new rules will be more readily apparent after the 2023 proxy season is more fully underway. So far, since the rules have become effective, there have been six situations (involving a U.S. company) in which it was publicly announced that a dissident stockholder submitted nominations for directors and the nominations have been resolved. In two of the six situations, a dissident's nominees were added to the board (in one case through election by the stockholders and in the other by settlement with the company); in three of the situations, the dissident withdrew its nominees before a stockholder vote; and in one situation, the dissident's nominees were not included in the election due to failure to comply with the company's advance notice bylaws.

- ***Aim ImmunoTech, Inc./Jorgl*—Dissident stockholder's nominees were not listed due to failure to comply with the company's advance notice bylaws**. A dissident stockholder group led by Jonathan Jorgl sought to nominate two candidates for Aim ImmunoTech's three-member board. The board rejected the nomination on the grounds that the nomination notice had not, as required by the company's advance notice bylaw, disclosed all members of the dissident's group and the arrangements and understandings involving those members. The Court of Chancery held that the nomination notice did not comply with the

advance notice bylaws, and as a result the dissident group could not nominate directors to the company's board this year, and that all proxies and votes in favor of their nominees would be disregarded. Accordingly, the company's proxy card listed only the company's nominees; and all of these nominees were elected.

- ***Argo/ Capital Returns Mgt.*—Dissident stockholder withdrew its nominees after ISS and Glass Lewis recommended voting against them.** Dissident stockholder Capital Returns Management nominated two candidates for Argo's seven-member board. The dissident's universal proxy card placed nominees into three categories: its two nominees were listed first; five of the company's nominees were listed next and identified as "acceptable"; and the two company nominees that the dissident was targeting for replacement were listed next and identified as "opposed." The company's universal proxy card listed the company's nominees first and identified them as "recommended"; and listed the dissident's nominees next and identified them as "opposed." On both cards, it was noted that if a stockholder voted for fewer than seven nominees, the card would be voted as instructed, but that if a stockholder voted for more than seven nominees, the card would be treated as invalid. ISS and Glass Lewis both recommended that stockholders vote for the company's seven nominees. Shortly thereafter, the dissident withdrew its nominees; and all of the company's nominees were elected.

- ***Aimco/Land & Buildings*—Stockholders elected one of a dissident stockholder's two nominees, following an ISS recommendation in favor of that nominee.** Dissident stockholder Lands & Buildings nominated two candidates for the three open seats on the ten-person classified board of Aimco (Apartment and Investment Mgt.). The dissident contended that the company had effected a spin-off that was not in the stockholders' interest and that the company had underperformed prior to and after the spin-off. The company argued that the board and management had been reconstituted since the spin-off and that the new directors had critical expertise that had already been instrumental, post-spin-off, in the company's successfully executing on strategic priorities. The dissident listed its two nominees first on its universal proxy card; next, the company nominee the dissident was not targeting for replacement was listed, and identified as "unopposed"; next, the company's two other nominees were listed, and identified as "opposed." The company's universal proxy card listed its three nominees first; and then the dissident's two nominees. On both cards, it was noted that if a stockholder undervoted, the card would be voted as instructed, but that if a stockholder overvoted, the card would be treated as invalid. Glass Lewis recommended that stockholders vote for all of the company's nominees; however, ISS recommended that stockholders vote for one of the dissident's proposed nominees. The dissident's nominee who was recommended by ISS was elected by a comfortable margin—while the dissident's second nominee, who was not recommended by ISS or Glass Lewis, received the lowest level of support of all the nominees.

- ***Blucora/Engine Capital*—Dissident stockholder withdrew its nominee.** Engine nominated one candidate to Blucora's board. The company stated that the candidate's skills would not be additive to the board. Engine withdrew its nomination. (Last year, Engine had withdrawn its nomination of three directors for election at the last annual meeting, following the company's appointment of new two independent directors; and thereafter Blucora sold one of its divisions, for which Engine had advocated.)

- ***Rogers/Starboard*—Company agreed to appoint two of the dissident stockholder's independent director nominees.** Following the late-2022 failure to close of an agreed sale of Rogers (at a price almost double the company's trading value at the time of the 2023 annual meeting) and the appointment of a new CEO, Starboard submitted nominees for four seats on Rogers' ten-person board. (Starboard had nominated three independent director candidates and three Starboard insiders, and stated it would later select just one of the insiders to nominate.) Starboard, which submitted the nominations just before the nomination deadline (possibly indicating that it was preserving its rights while already in discussions with the company) reportedly supported the new CEO. After several weeks of confidential discussions, Rogers agreed to appoint two of Starboard's nominees—both, independent director candidates—to the reconstituted nine-person board.

- ***Walt Disney/Trian*—Dissident stockholder withdrew its nominee after the company announced operating changes and restoration of its dividend (which resulted in a large gain for the dissident on its shareholdings).** Trian nominated its principal, Nelson Peltz, to replace Disney director Michael Froman on the company's twelve-member board. Froman, whose background is in global trade and international business, had joined the board in 2018. Trian cited concerns about the company's recent significant share price drop; failure of the board to instill a "culture of accountability," to properly plan for the CEO's succession, and to respond to constructive stockholder input; and the directors' low ownership of company stock and lack of attention to the company as many of the directors were serving as CEOs of other major companies. While not identifying why it had targeted Froman, Trian stated that Peltz had the experience, commitment and objectivity "to insist that Disney live up to its full potential." The company responded that Peltz lacked entertainment and technology skills and experience. The company later announced $5.5 billion in cost reductions and plans to reinstate the company's dividend—following which Trian withdrew its director nomination.

Focus on individual directors' qualifications and weaknesses. Both the Aimco and Argo contests (and to some extent the Walt Disney contest) highlighted a focus on the qualifications and weaknesses of the company's and the dissidents' respective individual nominees. In the Aimco contest, for example, the company argued that the board and management had been reconstituted since the spin-off and that the new directors had critical expertise that had already been instrumental, post-spin-off, in the company's successfully executing on strategic priorities. ISS stated that it was recommending one of the dissident's nominees as the targeted company's nominee was long-tenured on the board, and had a background and qualifications that overlapped with those of more recently appointed independent directors on the board, while the background and qualifications of the dissident's nominee would complement those of the other directors. The dissident's nominee who was recommended by ISS was elected by a comfortable margin—while the dissident's second nominee, who was not recommended by ISS or Glass Lewis, received the lowest level of support of all the nominees.

Observations. As noted, this early, small sample provides no basis on which to judge the impact of the new rules. We would observe that, while only one of the contests was resolved through a stockholder vote utilizing a universal proxy card, the settlements reached may have been influenced by the stockholders' ability to pick and choose among all the nominees in any vote. Finally, it appears that themes that emerged in these situations were not dissimilar to themes in past proxy contests, including a focus on individual directors' qualifications and weaknesses and strong influence of proxy firm recommendations.

Practice Points

- **Boards should be prepared for the following under the new universal proxy card regime:** (i) possibly more proxy contests and activist campaigns (at least by new, smaller or lesser-known activists); (ii) increased unpredictability of proxy contest outcomes; (iii) increased potential for one or two of a dissident's nominees to be elected (with stockholders able to add a new voice to the board without the major change and disruption associated with replacement of the entire board through election of a dissident's entire slate); (iv) increased vulnerability of individual directors with any arguable weaknesses—and, as a result of these, possibly more pressure to settle with dissidents to avoid a proxy contest.
- **Boards should proactively prepare for potential contested director contests.** A board should select candidates for election after careful consideration of their qualifications and potential vulnerabilities (such as lack of independence, long tenure, lack of relevant expertise, overlap of expertise with other directors, service on multiple boards, poor attendance, lack of diversity, and so on). The consideration should be made both on an individual basis and taking into account the composition of the board as a whole. A board should be prepared to address perceived vulnerabilities of its nominees. In selecting nominees, a board should take account of the skillsets needed for the company's mission-critical risks, as well as anticipated, developing or high-profile risks (such as relating to climate change, workforce issues, ESG or political issues, cybersecurity, and data privacy). In this effort, a board should seek to ensure that the company's D&O questionnaires, director biographies, and director skills matrices reflect best practices and are up-to-date. In addition, companies should review the consent language they use for director nominees to confirm that the language is appropriate under the modified bona fide nominee rule.
- **Boards should proactively prepare for other potential activist campaigns as well.** Activist activity is likely to be spurred by the current macroeconomic headwinds, bearish corporate earnings expectations, and disproportionate declines in stock prices as compared to earnings, as well as investors' continued strong focus on ESG issues. A board should proactively consider, from the point of view of an activist, what the company's vulnerabilities are to an activist campaign, and those vulnerabilities should be addressed to the extent possible. Any proposed or announced M&A transaction should be considered by the board as a potential trigger for an activist campaign advocating for a higher price or an alternative transaction. Also, activity in a company's stock and options should be monitored with a state-of-the-art watch program. Finally, the board should be kept current on potential activist challenges, with regular updates with respect to activity in the company's stock or options, industry trends, and stockholders' communications.
- **Boards should prioritize implementation of effective stockholder engagement programs.** A clear, effective communications program is critical. A company should try to develop one or a small number of clear, compelling key "messages," which should be articulated regularly and acted upon. Meaningful engagement with the company's key stockholders—including board-level involvement, two-way dialogue, addressing stockholders' concerns, and building strong relationships—should be a year-round effort. As to major institutional investors that have adopted "pass-through voting" (allowing their investors to vote directly on certain, or in some cases all, issues), engagement by the company may be necessary with both the major institutional investor and its major investors. Ongoing, effective communication and relationship-building by directors with proxy advisors (particularly during a contest) is also critical.
- **Companies should review, and consider amending, their advance notice bylaws.** Depending on the specific company and circumstances (including the company's overall governance and defensive profile, and whether

amendments can be accomplished "on a clear day" before any campaign against the company is commenced), boards should consider amending their advance notice bylaws as follows:

- ***Clarity:*** to ensure that they are clear and unambiguous;
- ***Expanded information requirements:*** to expand the information required to be provided with director nominations
- ***Rule 14a-19 requirements:*** to incorporate the Rule 14a-19 requirements into the bylaws—that is, to provide that, if a dissident fails to comply with Rule14a-19, the company will disregard any proxies and votes received for the dissident's nominees (although the company could do this anyway, without such an amendment), and to require that a dissident provide reasonable evidence that it has complied with Rule 14a-19;
- ***67% solicitation requirement:*** to specify that a stockholder submitting a nomination must solicit 67% of the voting power (although this requirement would apply even absent such a bylaw, but the SEC's CD&I indicates that, absent this bylaw, the company's proxy statement must disclose this requirement);
- ***No electronic contact information:*** to specify that the company will not be required to provide electronic addresses or contact information when providing shareholder lists in the context of a proxy contest; and/or
- ***White proxy card:*** to provide that any dissident furnishing a proxy card must use a color for the card other than white (so that management can use a white card, as it traditionally has).

Whether or not any or all of these amendments are made, a company should consider including in its proxy statement reference to the need for a dissident stockholder to comply not only with the advance notice bylaws but also with the additional requirements of Rule 14a-19(b).

- **Companies must act in good faith and reasonably when determining whether to accept or reject a director nomination (even one that is technically non-compliant).** A board should identify the proper corporate purpose for the company's advance notice bylaws; and, even if a notice that is received is not technically compliant with the bylaw requirements, the board must act in good faith and reasonably when determining whether to accept or reject it.

Developments in Officer Exculpation

At least fourteen Delaware corporations have now adopted charter amendments providing for exculpation of liability for officers for duty of care violations, as permitted pursuant to an amendment to DGCL Section 102(b (7) effective as of August 2022. Under the statutory amendment, Delaware expanded Section 201(b (7 to permit a corporate charter to provide for exculpation of liability for duty of care violations (*i.e.*, for grossly negligent actions so long as taken in good faith) not only by directors, but also officers. Unlike exculpation for directors, under the new law, exculpation for officers cannot include derivative claims (*i.e.*, the board still can sue an officer on behalf of the corporation). Since adoption of the new law, most Delaware corporations have taken a wait-and-see approach, seeking to determine institutional investors' and proxy firms' views on the issue, before embarking on a process to seek stockholder approval of a charter amendment to provide for officer exculpation.

We note the following developments since the new law has been in effect:

- ***ISS support.*** ISS recommended voting in favor of the charter amendment providing for officer exculpation in 12 of the 14 situations. In both cases in which ISS recommended against the charter amendment, ISS was recommending voting against all of the company's proposals (in one of these cases, ISS was opposing the company's proposed de-SPAC transaction that also was being voted on, and, in the other case, the company had not issued a proxy statement or financial results). ISS also has recommended voting in favor of four such charter amendments that have been proposed but not yet voted on this proxy season. In two cases, ISS recommended voting against the charter amendment (in one of these cases, ISS was opposing the company's proposed de-SPAC that also was being voted on, and, in the other case, ISS was making withhold recommendations for all of the directors up for election—although, notably, in one of the situations in which ISS recommended in favor, it did so notwithstanding that it was making withhold recommendations for five of the company's directors, including the Chair of the Governance Committee).
- ***Stockholder support.*** Stockholders approved the charter amendment in 11 of the 14 situations (with votes in favor by the following percentages of the total outstanding shares: 88.3, 87.4, 85.7, 82.6, 80.9, 77.2, 74.2, 71.8, 70.5, 60.6, and 50.1). In two of the three cases in which the stockholders did not approve the charter amendment, a majority of the outstanding

shares voted in favor of the amendment but there was a supermajority voting requirement. (We note also that, in 10 of the 14 situations in which the amendment was adopted, the vote in favor represented over 90% of the votes cast.)

Accordingly, ISS and stockholder support seems generally high for officer exculpation charter amendments (potentially even at companies with less than stellar governance records). Indeed, ISS has stated in recommendations it has issued in favor of such amendments that the amendments are likely to become common and that the failure to provide such protection might put a company at a disadvantage in recruiting officers.

We would note that officer demand for such protection may well accelerate given the continued expansion of potential liability for officers in Delaware court decisions.

We note also that companies with a multi-class capital structure including non-voting stock should focus on their procedure for adoption of such a charter amendment. There is litigation currently pending in the Delaware Court of Chancery seeking to void the officer exculpation charter amendments adopted at two companies, in both of which cases the company did not provide for a class vote by the company's non-voting stock. The plaintiffs in those cases claim that, under DGCL Section 242 (b)(2), a class vote of the company's non-voting stock was required for the exculpation charter amendment as such an amendment adversely affects the class. The plaintiffs have moved for summary judgment and briefing by the parties is underway.

Finally, we note that a company seeking stockholder approval of an officer exculpation charter amendment at its upcoming stockholder meeting will have to file a preliminary proxy statement for SEC review at least ten days prior to distributing the definitive proxy statement to shareholders.

Buyer is Held Liable for Not "Speaking Up" to Correct Proxy Disclosure About Its Interactions With Target's CEO Leading Up To Sale Process— Mindbody

In *In re Mindbody, Inc. Stockholder Litigation* (Mar. 15, 2023), following a full trial on the merits, the Delaware Court of Chancery held, in connection with the 2019 take-private sale of Mindbody, Inc. to a private equity firm, that Mindbody's founder and CEO breached his fiduciary duties by (a) tilting the sale process in favor of the buyer based on his self-interest and (b) failing to disclose to Mindbody's stockholders material facts about interactions he had with the buyer during the period leading up to the company's sale process. Notably, the court also held that the buyer was liable for aiding and abetting the Mindbody CEO's disclosure violations; and was not liable for aiding and abetting the sale process violations only due to a "procedural foot fault" by the plaintiffs in having asserted this claim too late in the litigation process. Chancellor Kathaleen McCormick awarded damages of $1 per share, based on evidence that the buyer, which paid a merger price of $36.50 per share, had expected to have to pay $37.50 per share to win the company.

Most notably, the decision highlights the potential for a buyer to be liable for aiding and abetting a target company's disclosure that in the court's view does not adequately describe the buyer's interactions with the target leading up to and/or during the sale process. The court held that, given the buyer's contractual obligation under the merger agreement to review the proxy materials before they were filed and to notify Mindbody of any material omissions it discovered, the buyer had "knowingly participated" in the disclosure breaches when it did not "speak up" to correct material omissions about its interactions with Mindbody's CEO. As such a contractual obligation is standard in merger agreements generally, the decision potentially has broad applicability. We do not read the decision to suggest, more broadly, that a buyer necessarily has an obligation to correct other kinds of target disclosure omissions about which it may have had knowledge but which did not relate to conduct that the buyer actually was involved in.

Other Notable Developments in Q1 2023

2022 SPAC Statistics

As has been widely reported, the SPAC boom of 2020-2021 ended in 2022. The total value of de-SPAC transactions with a U.S. target completed in 2022 ($59.9 billion) reflected an 84% decrease from de-SPAC transactions completed in 2021; while the number of de-SPACs (119) reflected a 40% decline. The number of SPAC IPOs in the U.S. (83) reflected an 86% decline from 2021; while proceeds from SPAC IPOs ($13 billion) reflected a 92% decline. Over the course of the

year, however, there was an uptick in de-SPAC transactions, with 15 de-SPACs (total value of $8 billion) completed in the first quarter of 2022, but 46 (total value of $22 billion) completed in the fourth quarter. The most active sectors for de-SPACs continued to be technology (although, due largely to a correction in tech stock prices, de-SPAC deal value in the sector declined by 90% compared to 2021) and healthcare (with both deal value and volume increasing in this sector compared to 2021). Industrials were the most active sector by deal value (and the third most active by number of deals). Notwithstanding the significant drop in de-SPAC activity in 2022 compared to the extraordinary level seen in 2021, de-SPAC activity is expected to continue at or above historic, pre-boom levels, particularly given that many existing SPACs face deadlines for completing a de-SPAC by year-end 2023. In addition, interest in de-SPACs with U.S. targets has been increasing among non-U.S. (particularly Asian-Pacific) SPACs.

2022 de-SPAC Trends

Notable trends reflected in the de-SPACs completed in 2022 included: high redemption rates prior to a de-SPAC; longer time periods for the SPAC's IPO to clear the SEC, for the SPAC to identify a de-SPAC target, and for a de-SPAC to close after the acquisition agreement was signed; somewhat increased use of fairness opinions in de-SPACs; somewhat decreased use of PIPE financing; almost all de-SPACs providing all-stock (rather than cash-and-stock) merger consideration; and a majority of de-SPAC deals being amended between signing and closing. Also of note is that, as declining valuations create opportunities for buyers, and many de-SPACed companies continue to have disappointing performance, there has been a growing trend of companies (especially in the technology sector) that recently have gone public (either through initial public offerings or de-SPACs) now engaging in take-private transactions (including several companies that went public as recently as the beginning of this year).

FTC Seeks to Ban Employee Non-Competes

On January 5, 2023, the Federal Trade Commission issued a notice of proposed rulemaking seeking to categorically ban noncompete agreements between employers and a broad class of "workers." The word "worker" is defined in sweeping terms and includes all employees (as proposed, even senior employees and executives), independent contractors, externs, interns, volunteers, apprentices, and sole proprietors who provide services to a client or customer. While the FTC's rule does not explicitly prohibit nondisclosure agreements (NDAs), non-solicitation agreements, or forfeiture for competition clauses, the proposal includes a functional test to determine whether such covenants effectively operate as noncompete clauses. The proposed rule is also retroactive, requiring the rescission of any such restrictive covenants currently in existence, and thus upsetting carefully negotiated prior bargains. Until now, limitations on employee noncompete agreements have generally been left to states and judged under a reasonableness standard, making the FTC's categorical ban a major departure from prior practice. While it is expected that any final rule will be challenged in federal court, this proposal marks the latest in ongoing efforts by the Biden administration to increase antitrust enforcement generally and in labor markets in particular.

See **here** our Antitrust and Competition Alert, *No More Employee Noncompetes?* In addition, see **here** our M&A/PE Quarterly, *Where Things Stand at the End of 2022—Non-Competes,* where we discuss *Kodiak* (Del. Ch. Oct. 2022), and the FTC's ARKO/GPM action, which establish that a noncompete agreed in the context of the sale of a business can extend only so far as protecting the goodwill of the business that was acquired, and not the goodwill of the buyer's other businesses. Also of note, in *Kodiak,* the court indicated a reluctance to blue-pencil non-competes and instead held the overbroad non-compete entirely unenforceable; and the FTC brought its action against ARKO almost a year after the transaction (which was not reportable under the HSR Act) had closed, and the FTC, as part of the settlement order, also invalidated similar, already-existing non-competes that ARKO had obtained in other transactions.

Chancery Finds Non-Compete (Entered Into When Business Was Sold) Non-Enforceable–*Intertek*

In *Intertek Testing Services* NA v. Eastman (Mar. 17, 2023), Intertek acquired a business co-founded by Eastman. In connection with the sale, Eastman received consideration of $10 million, and he agreed not to compete anywhere in the world with the business that was sold. Three years after the sale closed, Eastman invested in and joined the board of a start-up company formed by his son. Intertek sued Eastman alleging a violation of the non-compete agreement. The court held that the non-compete was "unreasonable and unenforceable." The court stated that the "geographic scope [of the non-compete] far exceed[ed] any legitimate economic interests that Intertek might have in protecting the assets and goodwill it acquired"; and the court specifically "decline[d] Intertek's invitation to blue pencil the provision." The court observed that the acquired business provided services on a nationwide basis (at most), not globally. "Although relatively

broad restrictive covenants have been enforced in the sale of a business context, such covenants must be tailored to the competitive space reached by the seller and serve the buyer's legitimate economic interests," while the provision at issue was "as broad as one can imagine" (covering the entire world) and "extend[ed] to markets untouched by [the business that was sold]." The court granted Eastman's motion to dismiss.

Continued Politicization of ESG

While corporate boards and investment managers have incorporated a strong focus on ESG (environmental, social and governance) issues into their regular decision-making and priorities, ESG has become highly politicized in the U.S. Legislatures in blue-leaning states (including New York, Illinois and Maine) have passed laws or state pension initiatives to promote the consideration of ESG factors in investment decisions; at the same time, legislatures in at least 23 red-leaning states (including Texas and Florida) have passed or proposed laws or initiatives to prohibit or restrict state pension funds or agencies from doing business with investors and companies that consider ESG factors in their investment decisions. These "anti-ESG" laws and initiatives typically are written broadly, but we would note that most contain exceptions and that their interpretation is still evolving. Nonetheless, they have had substantial effects.

For example, Texas has banned ten major financial firms from obtaining contracts with Texas state and local agencies based on the firms allegedly having cut or reduced investments in fossil fuel companies due to ESG considerations; and has removed almost 350 individual investment funds from state pensions on the grounds that they consider ESG factors in making their investment decisions. Florida announced that it would pull $2 billion of the state's pension funds over concerns about ESG-based investing by Blackstone, although it later announced that it will allow Blackstone to continue to oversee those funds so long as it stops applying ESG investing strategies with respect to the funds. Florida also recently issued guidelines that will prohibit state-run fund managers from considering ESG factors when making investment decisions.

In 2023, Wyoming joined the anti-ESG bandwagon, proposing the "Stop ESG State Funds Fiduciary Act." This law would require parties to state contracts to certify that they do not engage in "boycotting" or "discriminating against" the following: fossil fuel, energy, timber, mining, agriculture, or firearms companies; companies that do not meet, are not expected to meet, or do not commit to meet environmental standards or disclosures relating to greenhouse gas emissions, or relating to certain corporate board, employment, compensation or disclosure criteria; or companies that do not "facilitate access to abortion, sex or gender change or transgender surgery."

On the federal front, in March 2023, the U.S. Senate voted to block a U.S. Labor Department rule that was intended to undo a Trump-era Department of Labor rule that limited investment managers to considering only purely financial factors (and not ESG factors) when making investment decisions. The House of Representatives had already passed a similar version of the bill. On March 20, President Biden vetoed the bill.

In light of the conflicting state regimes and conflicting federal-state regimes, asset managers and private equity firms need to keep informed about pro- and anti-ESG legislation and policies; identify the exceptions and carveouts provided in the small-print of these laws and policies; keep abreast of regulatory and judicial interpretation of the laws and policies; monitor their compliance with these conflicting regimes; review their ESG-related policies, procedures and disclosures to determine if they need to be clarified, strengthened or amended; understand and balance the conflicting interests of their stakeholders with respect to ESG issues; and proactively prepare for political and legal challenges to their ESG-related policies and decisions.

Celebrity Promoters Beware

Celebrities have become regular promoters of investments in cryptocurrencies and SPACs. On February 17, 2023, the SEC announced that it had brought charges against former NBA player (and Hall of Famer) Paul Pierce for promoting EMAX tokens (a cryptoasset offered by EthereumMax) on social media. The charges stemmed from Pierce's, allegedly, not having disclosed the payment he received for making the promotion (namely, $244,000 worth of EMAX tokens) and for having tweeted misleading statements about EMAX (including a screenshot of an account showing large holdings of EMAX and large profits, without disclosing that his own holdings were much lower). Pierce, without admitting or denying the SEC's findings, agreed to settle the charges by paying $1.409 million and committing not to promote any cryptoasset securities for three years.

On March 22, 2023, the SEC announced a lawsuit against the owner of BitTorrrent Inc. for not registering the crypto coins Tronix and BitTorrent, while at the same time announcing a settlement with celebrity backers for allegedly not disclosing their promotional payments—including the actress Lindsay Lohan, who will pay $40,000, and the social media personality Jake Paul, who will pay $100,000.

FTC Commissioners Advocate for Extended Time to Review HSR Filings

In a statement submitted with the FTC's annual report to Congress on the Hart-Scott-Rodino Act, the Democratic commissioners of the FTC called for legislation to extend the time periods for the FTC's review of HSR filings. The Commissioners, noting that notified transactions surged by 115% in 2021 (to "historic levels"), posited that the FTC should not have to rely on "permission from merging parties" (in voluntary timing agreements) to have sufficient time to review mergers. They stated that the 30-day window the statute provides for the agencies to assess whether a transaction warrants opening an in-depth investigation, and the 30-day window in which the agencies must decide whether to challenge a transaction after the merger parties certify that they have substantially complied with the agencies' Second Requests, "are no longer adequate."

Company Withdraws Advance Notice Bylaw Amendments that Required Unusually Extensive Information

Masimo Corp. announced in late February 2023 that it was withdrawing the amendments it had adopted to its advance notice bylaws that required expanded information from investors making director nominations or stockholder proposals. A lawsuit, *Politan Capital Management LP v. Kiani,* had been filed in the Delaware Court of Chancery claiming that the amendments were invalid and unenforceable, and that the Masimo board of directors had breached their fiduciary duties by adopting them. The Mutual Fund Association (an advocacy group for hedge funds) had filed an amicus brief with the court, arguing that the amendments were "draconian," and that if the court determined that they were enforceable, many other companies would adopt similar provisions, requiring far more expansive disclosure than has been the case in advance notice bylaws previously evaluated by the court. MFA argued that widespread implementation of similar bylaws would limit stockholders' incentives and ability to engage with management teams and boards to effect beneficial change and would impact capital allocation decisions at both activist and non-activist investment funds.

Specifically, MFA urged the Court to declare invalid the provisions in the proposed bylaws that would require an investment fund manager that makes a director nomination or stockholder proposal to disclose: (i) the identity of each individual investor in the fund that holds a 5% or larger economic interest in the fund or has invested or committed to invest in a "sidecar vehicle" or special purpose entity formed principally for the purpose of investing in the company's securities; (ii) whether the fund (or a related person) has any plans or proposals to nominate directors at any other public company within the next 12 months; and (iii) the identities (and share ownership) of other company stockholders known by the fund to "support" the nomination or proposal. The MFA argued that, with respect to (i) above, funds generally have confidentiality agreements with their investors preventing the disclosure of their identities; with respect to (ii), funds consider their investment plans to be highly sensitive, proprietary intellectual property; and, with respect to (iii), the concept of "support" (which is undefined in the bylaw) is unworkably vague and apparently not subject to any standard of materiality.

Delaware Supreme Court Weighs In On When "And" Means "Or"

The Delaware Supreme Court, in a decision issued March 16, 2023, affirmed the Court of Chancery's 2022 ruling in *Weinberg v. Waystar*. Justice Karen Valihura provides an extensive account of the various ways that drafters' use of the word "and" has led to interpretive confusion—with emphasis on a split that has developed over the last two years among at least seven federal circuit courts of appeal regarding use of the word "and" in a federal criminal statute (an issue now to be decided by the U.S. Supreme Court, which has granted *certiorari*). This "epic battle" among the federal courts "illustrates the range of possible interpretations our federal appellate sister courts have endorsed in construing 'and,'" the Justice wrote.

Weinberg underscores the critical importance of clarity in drafting, including, where appropriate, providing supplementary language to clarify even commonly used words. The case highlights that the word "and" at the end of a list may not convey clearly whether the list is "joint" (*i.e.*, refers to *all* of the items listed, together, in the conjunctive sense) versus "several" (*i.e.*, refers to *any one or more* of the items listed, alone, in the disjunctive sense). Rather than stating that something is applicable "in the event of (x) and (y)," a drafter should consider being more specific—such as, for a "joint" list, specifying: "in the event of both (x) and (y) (with neither alone being sufficient)"; and, for a "several" list, specifying: "in the event of either (x) or (y) or both."

In *Weinberg*. the Court of Chancery interpreted a stock option agreement that stated that the company had a call right, exercisable at its discretion within six months of the employee grantee's termination, if the employee (x) was terminated for any reason "and" (y) had violated a restrictive covenant. The company terminated the employee and exercised the call right; both parties agreed that the employee had not violated a restrictive covenant. The Court of

Chancery held that only (x) or (y) (not both) had to be satisfied; and, therefore, the company was entitled to exercise the call right. The Supreme Court found "sufficient and compelling" the lower court's reasoning that a different interpretation would have rendered meaningless certain other provisions of the agreement at issue. The Supreme Court also concluded that: (i) "the permissive use of 'and' here suggests its 'several' sense" (the call right was "a restriction on [the employee]'s rights," suggesting that the company retained a broad call right); (ii) a reading of "and" in its "joint" sense "produces an illogical result" (namely, that the company would be prevented from exercising its call right despite an employee's for-cause termination, other than one based on a restrictive covenant breach); and (iv) "the several use of 'and' aligns with the scheme of the [employee option] plan" (namely, to align the employee's interests with those of the company's stockholders).

New Legislation to Grant Broad Government Authority Over ICT-Related National Security Threats

On March 7, 2023, the RESTRICT Act (Restricting the Emergence of Security Threats that Risk Information and Communications Technology) was introduced in the U.S. Senate and endorsed by the Biden Administration. The Act has wide bipartisan support and is expected to be enacted into law. The sweeping bill would empower the U.S. Secretary of Commerce and/or the U.S. President to mitigate threats by "Foreign Adversaries" to the U.S.'s information and communications technology and services sector. While various other legislation has been proposed targeting specific Chinese apps that may be a risk to national security, the proposed Act is far broader in that it targets all foreign adversaries as well as a wide range of technologies and software. The Act would expand the authority granted to the government under existing rules established under an ICT-related executive order—most notably because the Act covers not only transactions but also "Covered Holdings" (i.e., controlling ownership interests, whether existing or contingent, that Foreign Adversaries, or other "covered entities," hold in entities that own, control or manage ICT products or services). The Act would authorize the government to block proposed transactions, order divestment, and/or enforce other mitigation remedies. It remains to be seen when and in what final form the legislation will be enacted; how it will interact with CFIUS (the Committee on Foreign Investment in the U.S.); who will be identified as Foreign Adversaries (beyond those named in the Act, which are China (including Hong Kong and Macao), Cuba, Iran, North Korea, Russia, and Venezuela); and how it will be applied.

Fried Frank M&A/PE Briefings Issued This Quarter

Fried Frank issued the following Briefings on key Delaware judicial decisions and developments during this quarter (please click on the title to read the full Briefing):

Chancery Expands Caremark *Parameters—But Dismisses Claims Against McDonald's Directors Because They Took Action to Address Sexual Harassment Once They Learned of It*

In *In re McDonald's Corp. Stockholders Derivative Litigation* (Mar. 1, 2023), the Court of Chancery, at the pleading stage of litigation, dismissed the derivative claims, brought against former and current directors of McDonald's Corp., that alleged the directors had failed to fulfill their duty of oversight with respect to rampant sexual harassment at the company. Vice Chancellor Laster agreed with the plaintiffs that so-called "red flags" had put the board on notice about the problem; but the Vice Chancellor dismissed the claims on the grounds that, once the directors learned of the problem, they took action to address it. On the one hand, this decision, and the earlier decision in the case (see below), appear to expand the potential for *Caremark* liability beyond the parameters many legal analysts had understood to apply. For example, the court articulated or clarified, for the first time, that: (i) *Caremark* duties of oversight apply not only to directors but also to officers; (ii) *Caremark* duties apply not only to a company's so-called "mission critical risks" but, depending on the facts, may apply to other key risks even if not rising to the level of mission critical; and (iii) sexual harassment and similar issues—and, indeed, "maintaining workplace safety…[and] tak[ing] care of the corporation's workers"—are mission critical risks for companies. On the other hand, however—and perhaps most importantly as a practical matter—*McDonald's* reinforces that there is a high bar to a finding of *Caremark* liability, as it is only when directors or officers act in bad faith that *Caremark* liability arises. Directors or officers who acted to address a problem once they learned of it generally would not be deemed to have acted in bad faith, even if the actions were insufficient or reflected poor decision-making (so long as they were not so off the mark as to suggest bad faith), the court stated.

Officer May Have Liability for Ignoring "Red Flags" of Sexual Harassment Problem at the Company (Under Caremark*)—and for his Own Sexual Harassment (As a Duty of Loyalty Violation)—*McDonald's

In the first decision issued in *In re McDonald's Corporation Stockholder Derivative Litigation* (Jan. 25, 2023), the Court of Chancery rejected dismissal of *Caremark* claims against McDonald's Corp.'s former head of human resources that alleged that he failed to exercise oversight over rampant sexual harassment at the company. The court, at the pleading stage of litigation, held, for the first time, that not only directors but also officers have *Caremark* duties of oversight. The court held that the head of human resources had a fiduciary duty to oversee the risk of sexual harassment. The court found it reasonably conceivable at the pleading stage that: (i) the officer had ignored red flags that sexual harassment was occurring at the company; and, (ii) as he himself allegedly had engaged in sexual harassment of employees, he had *consciously* (*i.e.,* with bad faith intent) ignored those red flags of the same misconduct by others. In addition, the court found that, as the officer's alleged sexual harassment of employees was done for his own self-interest and was not in the best interests of the company, he may have breached his fiduciary duty of loyalty, even apart from his *Caremark* oversight duties. (As discussed in the first article in this Quarterly, the court subsequently dismissed the claims against the officer on demand futility grounds.)

*Chancery Grants Judicial Validation of SPACs' Potentially Defective Charter Amendments and Share Issuances Effected Without a Class Vote of Class A Shares—*Lordstown

Many SPACs, in connection with de-SPAC mergers, approved charter amendments authorizing an increase in the number of their authorized shares of Class A Common Stock to facilitate the issuance of shares required for the merger. Based on widely accepted legal advice at the time, such amendments typically were approved by vote of the Class A and Class B Common Stock voting together. However, in a December 2022 decision, *Garfield v.* Boxer, which came as a surprise to corporations and legal practitioners, the Delaware Court of Chancery indicated that such amendments require, in addition, a separate vote of the Class A common shares. In response to the uncertainty created by *Garfield* as to the validity of such charter amendments that were approved only by a joint vote, and the uncertainty as to the validity of the billions of shares that have been issued based on such amendments, the court indicated, in *In re Lordstown Motors Corp.* (Feb. 22, 2023), that, absent unusual circumstances, it will grant requests, made pursuant to DGCL Section 205, for judicial validation of such amendments and share issuances. In bench rulings (Feb. 20, 2023), the court granted Section 205 petitions on this issue that had been submitted by Lordstown and five other companies; hearings on the additional 30 such petitions the court has received are being scheduled for the coming weeks; and the court expects to receive more such petitions. The issue potentially extends to other corporate acts as well that were taken based on charter amendments approved only by a joint vote of common shares—such as amendments providing for officer exculpation from liability.

*Chancery Rejects Claims CEO Steered Target Board to Favor Financial-Buyer Bid Over Higher Strategic-Buyer Bid to Retain His Position Post-Merger—*Teamsters v. Martell

In *Teamsters Local v. Martell* (Feb. 1, 2023), the Court of Chancery, at the pleading stage of litigation, dismissed claims that the former CEO-director of CoreLogic, Inc. breached his fiduciary duties in connection with the $6 billion sale of the company to Stone Point Capital and Insight Partners. The plaintiff alleged that the "real reason" the CoreLogic board chose the bid submitted by Stone-Insight (a financial buyer), over a competing all-stock bid with a higher implied value submitted by CoStar Group, Inc. (a strategic buyer), was that the board deferred to the CEO's desire to sell to a financial buyer so that he would retain his job post-merger. The plaintiff relied primarily on public comments by CoStar's CEO, made after the Stone-Insight merger closed, that suggested that the sale process was infected by what he considered to be a usual preference by senior managers for financial buyers over strategic buyers based on their view that the former often retain senior management while the latter often do not. The court held that the plaintiff had alleged no particularized facts from which it could be inferred that CoreLogic's CEO had an entrenchment motive; that he had in fact steered the board away from a deal with CoStar; nor, in any event, that he had influenced the independent and unconflicted board. The claims were not sustainable based solely on "speculation and innuendo" arising from the CoStar CEO's public comments about the sale process, particularly as the plaintiff had conducted a Section 220 investigation of the corporate books and records and had cited nothing in these documents to substantiate the claims and the board had seemingly valid concerns about the CoStar bid (including value uncertainty and antitrust issues).

*Chancery's Second Decision on SPAC Fiduciary Duties Reaffirms Entire Fairness Review But Still Leaves Open Whether It Would Apply if Disclosure Was Adequate—*Delman

In *Delman v. GigAcquisitions3* (Jan. 4, 2023), the shareholder-plaintiff claimed that the sponsor of a SPAC, the sponsor's controller, and the SPAC's directors undertook a value-decreasing de-SPAC transaction that benefitted them to the detriment of the public stockholders for whom, the plaintiff argued, liquidation of the SPAC would have been

preferable. The Court of Chancery, applying longstanding Delaware fiduciary principles, and reaching the same result as in last year's *MultiPlan* decision, held at the pleading stage that, based on conflicts of interest inherent in the typical SPAC structure, the most onerous standard of judicial review—entire fairness—applies to the court's evaluation of fiduciary claims in connection with a de-SPAC transaction. In addition, the court held (as in *MultiPlan*) that it was reasonably conceivable (the standard of proof at the pleading stage) that the de-SPAC at issue was *not* entirely fair. Importantly, as the court found in both *Delman* and *MultiPlan* that the disclosure to stockholders may have been materially inadequate (such that the stockholders' redemption right was impaired), it remains an open question whether entire fairness would apply to a de-SPAC challenge in a case in which the court found that the disclosure was adequate.

Delaware Supreme Court Holds Controller is Not Liable for its "Opportunistic and Manipulative" Conduct, as Fiduciary Duties Were Contractually Waived—Boardwalk Pipeline v. Bandera

In *Boardwalk Pipeline Partners, LP v. Bandera Master Fund LP* (Dec. 19, 2022), the Delaware Supreme Court reversed a Court of Chancery decision (Nov. 12, 2021) that had ordered the general partner of Boardwalk (a master limited partnership) to pay the former public unitholders almost $700 million in damages in connection with the general partner's $1.56 billion take-private of Boardwalk. Notably, the Supreme Court did *not* overturn the Court of Chancery's factual findings that the General Partner and its affiliates had (i) opportunistically timed the take-private to occur during a temporary period of regulatory uncertainty and declining prices for Boardwalk's units, and (ii) manipulatively pressured their law firm to deliver a "contrived," "sham" opinion to satisfy the sole condition to the general partner's exercise of its call right to acquire the public units. *Nonetheless*, the Supreme Court overturned the Court of Chancery's legal holding that the general partner was liable for willful misconduct.

Instead, the Supreme Court viewed the general partner as simply having made "full use" of the broad "flexibility" a controller is permitted under Delaware law when its fiduciary duties have been contractually eliminated and the absence of those duties has been fully disclosed to investors. The Supreme Court also held that the opinion of counsel the general partner obtained satisfied the contractual condition to exercise of the call right. The Supreme Court stated that the "proper focus" for the court was not on the validity of the legal opinion but on whether the general partner had acted reasonably in relying on it. The general partner had acted reasonably in relying on it, the Supreme Court concluded, based on its having obtained and relied on a second opinion from another law firm—which was not challenged—that opined that it would be within the general partner's reasonable judgment to decide to rely on the first opinion. As the partnership agreement provided a conclusive presumption of good faith for the general partner when relying on advice of counsel, the general partner was presumed not to have engaged in willful misconduct and was entitled to exculpation from damages.

RoundUp

2023 First Quarter Highlights

Deals:

- Counsel to Yellow Wood Partners in its acquisition of beauty and personal care brand Suave from Unilever.
- Counsel to AEA Investors and its portfolio company, Scan Global Logistics (SGL), in AEA's $1.67b sale of its majority shareholding in SGL to CVC Capital Partners Fund VIII.
- Counsel to Sterling Check Corp. in its acquisitions of Socrates Ltd. and A-Check Global.

Accolades:

- Philip Richter and Andrea Gede-Lange were listed in MergerLinks' 2022 Top Lawyer lists, Phil in the Healthcare and Top Advisor categories, and Andrea in the Private Equity and Top Female M&A Lawyer categories.
- Fried Frank's Private Equity practice was listed among Law360's 2022 Private Equity Groups of the Year.

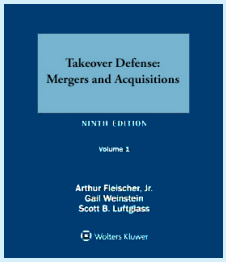


Recent Fried Frank M&A Quarterlies

- Fall 2022
- Spring 2022
- Winter 2022

Takeover Defense: Mergers and Acquisitions

The Ninth Edition of Fried Frank's "Takeover Defense: Mergers and Acquisitions," a one-of-a-kind resource by corporate senior counsel Arthur Fleischer, Jr. and Gail Weinstein and partner Scott B. Luftglass, has recently been published. The treatise is a comprehensive, must-have resource for practitioners representing any participant in M&A activity, including bidders, sellers, senior management, sponsors, and investment banks.



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