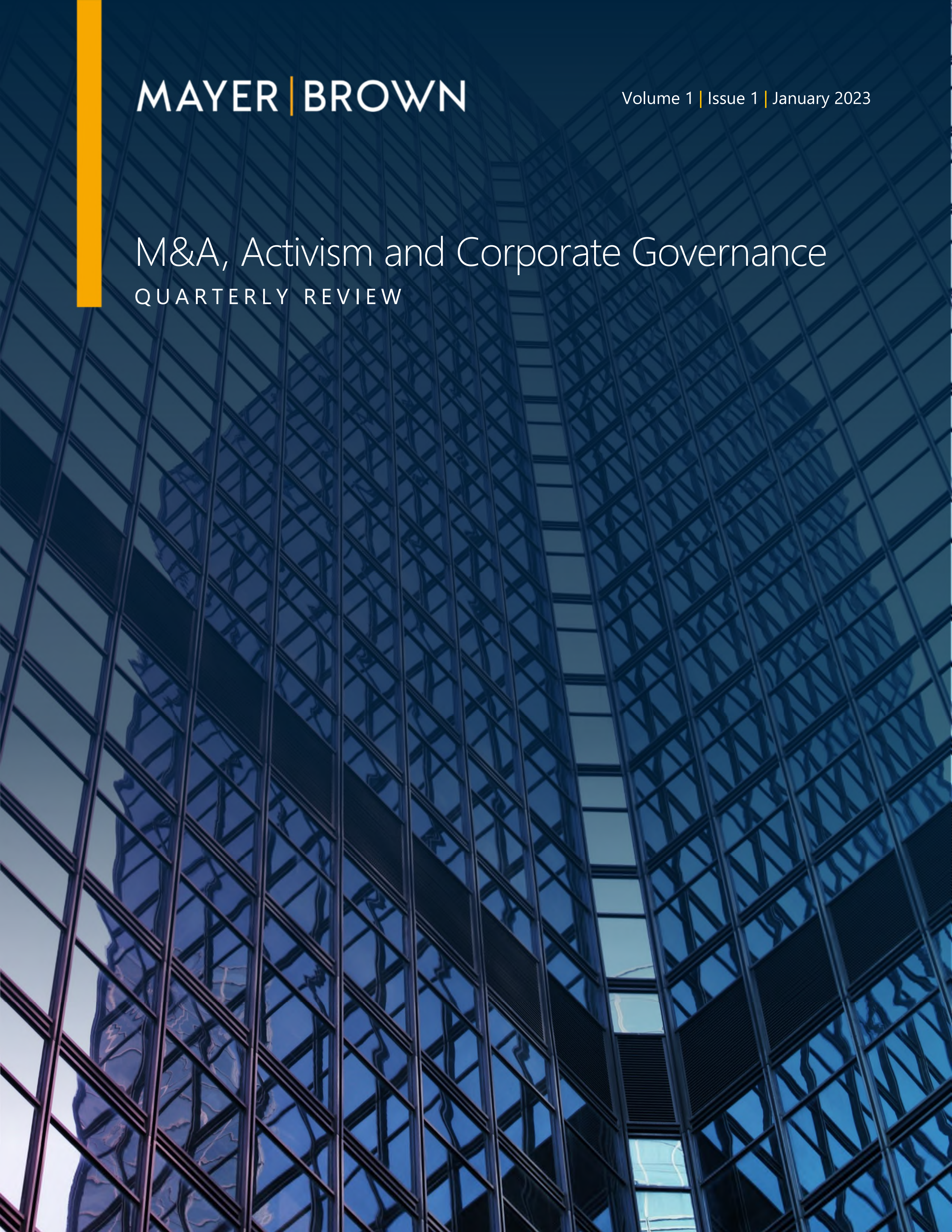

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M&A, Activism and Corporate Governance

QUARTERLY REVIEW

Introduction

The *M&A, Activism and Corporate Governance Quarterly Review* is Mayer Brown's quarterly publication designed to keep you current on key legal developments involving mergers and acquisitions, shareholder activism and corporate governance matters.

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In This Issue

M&A Lawyers Adapt to New Era of Antitrust Enforcement: How Contractual Provisions Are Evolving

By: Martha McGarry, Andrew Noreuil, Camila Panama, William Stallings and Gail Levine

Throughout 2022, the Department of Justice's Antitrust Division (the "DOJ") and Federal Trade Commission ("FTC") continued with aggressive enforcement efforts. As a result, parties to transactions have come to anticipate longer merger review timelines, more frequent second requests and a higher likelihood that litigation against the government will be needed in order to get deals closed. Furthermore, despite a string of enforcement action losses in court during 2022, the agencies' efforts have resulted in a meaningful number of abandoned transactions, whether during an in-depth second request process or after the FTC or DOJ filed a complaint initiating litigation. These recent developments have led to modifications of customary terms of acquisition agreements, as M&A lawyers seek to address issues resulting from this new regulatory environment. Below, we highlight provisions of certain acquisition agreements that parties have used to navigate the increase in regulatory deal risk.

Longer "Drop-Dead" Dates: Prior to 2021, most acquisition agreements had a termination date of 12 months or less, with an extension of up to six months in the event of delays in obtaining regulatory clearance. Recently, however, with the prospect of a more drawn-out regulatory process, some parties have opted for longer "drop-dead" dates. For example, the agreements for **JetBlue's $3.6 billion[1] acquisition of Spirit Airlines, CVS Pharmacy's $7.2 billion acquisition of Signify Health and Kroger's $19.5 billion acquisition of Albertsons** all provide for termination dates that can be extended out to two years in order to obtain regulatory approval. Long termination dates can be subject to active negotiation, however, as some parties may prefer to preserve the right to terminate the transaction if the regulatory process continues for well over a year. For example, a shorter termination date might be preferred by a buyer that is using committed financing to pay the purchase price or a target company that would like to escape compliance with interim operating covenants in the acquisition agreement if the transaction becomes subject to a long regulatory review. A shorter termination date might also be preferred by a target company that is looking to reduce uncertainty for its customers and other business partners or minimize loss of employees.

Reverse Termination Fees Scaling with Antitrust Risk: The current enforcement regime has pushed parties to do a more thorough antitrust analysis at the beginning of a potential transaction, prior to the acquisition agreement being executed. As a result, parties are able to better understand potential "problem areas" and the likelihood of government challenge and fashion terms to reflect the parties' allocation of closing risk. While a target company would typically negotiate for a reverse termination fee in the event the transaction is terminated for failure to obtain antitrust clearance, some acquisition

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[1] Transaction values throughout this article are equity value as provided by *Deal Point Data*.

agreements are providing for more than the typical reverse termination fee structure. In several recent deals, the reverse termination remedies have had features beyond a single fee amount and were tailored to account for the passage of time during the pendency of the regulatory review process or specific business needs of the target companies. For example:

- **Google's $5.4 billion acquisition of Mandiant**: The buyer agreed to pay Mandiant a higher reverse termination fee the longer the regulatory review process continued. The reverse termination fee started at $328 million (which amount was effective through one year after signing), and then would increase to $394 million for the period thereafter and through 15 months after signing, and then to $460 million after that.
- **Microsoft's $74 billion acquisition of Activision**: Similar to the Google/Mandiant fee, the reverse termination fee started at $2 billion (which amount was effective through one year after signing), and then would increase to $2.5 billion for the period thereafter and through 15 months after signing, and then to $3 billion after that.
- **Medtronic's $936 million acquisition of Intersect ENT**: The buyer agreed to provide Intersect with a credit facility of up to $75 million, funded in five quarterly tranches, at the option of Intersect. If the transaction did not close due to failure to obtain regulatory clearance, repayment of the amounts outstanding under the credit facility (plus accrued and unpaid interest) would be waived.

Use of Ticking Fees: "Ticking fees" can be useful if parties anticipate longer regulatory timelines. "Ticking fees" can be structured in different ways, but generally provide a mechanism for target company stockholders (as opposed to the target company itself, such as in the case of reverse termination fees) to receive additional consideration as the time between signing and closing stretches past certain specified milestones. Some recent examples of the use of ticking fees include:

- **Standard General's $5.1 billion acquisition of TEGNA**: In addition to receiving the base price per share, TEGNA stockholders were entitled to receive a daily per share ticking fee equivalent to $0.05 per month if the closing occurs between the 9- and 12-month anniversary of signing, increasing to $0.075 per month if the closing occurs between the 12- and 13-month anniversary of signing, $0.10 per month if the closing occurs between the 13- and 14-month anniversary of signing and $0.125 per month if the closing occurs between the 14- and 15-month anniversary of signing.
- **JetBlue's $3.6 billion acquisition of Spirit**: JetBlue agreed to pay $0.10 per share per month to Spirit stockholders (commencing on a specified date) until the closing or termination of the transaction. If the closing of the transaction were to occur during the first 12 months during which the payments were made, the payments would be treated as pre-payments of the base price per share in the deal, thereby reducing the per share amount paid at the closing, up to a maximum aggregate reduction of $1.15 per share. However, if the closing were to occur after the first 12 months during which payments were made, any payments in excess of $1.15 per share would not be treated as pre-payments of the base price per share and instead would thereby increase the aggregate per share amount paid to Spirit stockholders. Importantly, in a twist on the typical ticking fee mechanism, if the transaction were to be terminated, Spirit stockholders would be entitled to retain all amounts they had been paid prior to termination.

Negotiating Remedies into the Acquisition Agreement: Given the increased likelihood of government challenge, and thus the need to litigate in order to get a transaction completed, some parties are negotiating into acquisition agreements the structural remedies that they will proffer to obtain regulatory clearance. For example:

- **Kroger's $19.5 billion proposed acquisition of Albertsons**: The parties agreed to, if necessary, divest up to 650 Kroger and/or Albertsons stores (in total). As of the time of this publication, the transaction is under review by the FTC.
- **JetBlue's $3.6 billion proposed acquisition of Spirit Airlines**: The buyer agreed to, if necessary, divest certain assets set forth on a schedule, as well as to make any other divestitures determined in its sole discretion. As of the time of this publication, the transaction is under review by the DOJ.

We have also now seen how this approach has played out in some of the transactions that were signed up earlier in the current antitrust administration's tenure. For example:

- **UnitedHealth's $7.8 billion acquisition of Change Healthcare:** The parties agreed in principle that divestitures could occur, and, while the DOJ investigation was ongoing, UnitedHealth announced its intent to sell a certain business of Change Healthcare to a private equity firm if such a divestment was required to obtain regulatory approval for its acquisition of Change Healthcare. UnitedHealth and the private equity firm entered into a purchase agreement after the DOJ initiated litigation challenging the deal. The US District Court for the District of Columbia later held that the antitrust issues that the DOJ had identified were remedied by the parties' proposed divestiture, which the DOJ had rejected, and the transaction was cleared to close.
- **Medtronic's $936 million acquisition of Intersect ENT**: The parties agreed to the divestiture of a business that had been acquired by Intersect in the prior year. This remedy was accepted by the FTC as a condition to clear the transaction.

Infrequent Use of "Hell or High Water" Standard: The "hell or high water" efforts standard, requiring that the buyer take on all antitrust risk and do everything that is required to obtain clearance of the transaction, is rare and is used in only a small minority of acquisition agreements. A recent example of a hell or high water provision can be found in the agreement for **Danfoss's $3.3 billion acquisition of Eaton**, which did not have a reverse termination fee. Notably, in the current regulatory environment, a hell or high water efforts standard might not provide sellers the same level of closing certainty as they might have expected in the past. In transactions where enforcers will not accept any remedies and will not clear a deal under any circumstances, there will be nothing that a buyer can do to obtain transaction clearance and a hell or high water provision will not affect that. In those cases, a seller would be well served to have express remedies, such as a reverse termination fee, provided for in the agreement. In addition, when comparing the potential remedy offered by a hell or high water provision against that of a reverse termination fee, rather than go to court to fight over whether the buyer did all that it was required to do under the efforts covenant, a target company might prefer to instead collect a known payment if the transaction does not close by a particular date.

In light of continued antitrust enforcement efforts, it remains critical for M&A lawyers to continue to work closely with their clients to identify creative and deal-specific approaches to mitigating regulatory closing risk.

The Universal Proxy Rules Are in Effect: Key Takeaways from Recent Proxy Contests and What to Watch

By: Martha McGarry, Andrew Noreuil and Camila Panama

The amendments to Rule 14a-19 of the Securities Exchange Act of 1934 (the "universal proxy rules") went into effect on September 1, 2022. As a result, now, in the context of a contested director election, the company and dissident stockholders are required to use a "universal proxy card," listing all director candidates. This permits stockholders to mix and match across nominees of the company and the dissident—which was previously only possible by voting in-person at the stockholders' meeting. Below are key takeaways from select recent proxy contests and what we expect to see play-out as 2023 progresses.

Select Recent Proxy Contests: We highlight the following two completed campaigns, which both took place under the universal proxy rules:

- Capital Returns Management, LLC ("CRM") sought two of seven board seats at Argo Group International Holdings, Ltd ("Argo"). On December 12, 2022, Argo issued a statement confirming that CRM had withdrawn its director nominations—just days before the December 15, 2022 annual stockholders' meeting.
- Land & Buildings Investment Management ("L&B") sought two of three board seats on Apartment Investment and Management Company's ("AIMCO") classified board. The proxy contest went all the way to AIMCO's December 16, 2022 annual stockholders' meeting, where L&B won one board seat. This was the first contested election taken through to a vote following the effectiveness of the universal proxy rules.

Proxy Contests Will Focus on Individual Directors (as Opposed to Slates): Stockholders are no longer choosing between full slates of nominees and their collective merit. Now, stockholders can easily split their votes among company nominees and dissident nominees, on a director-by-director basis—pitting a dissident's best individual nominees against the company's perceived "weakest" nominees.

- In the L&B proxy contest, stockholders showed that they understood they were no longer tied to one party's full slate when voting via proxy card. L&B put forth two director nominees, but AIMCO stockholders elected only one of those nominees, voting out an AIMCO incumbent director who had served on the board for 18 years.
- As both CRM and L&B had only nominated short slates (i.e., fewer nominees than there were board seats up for election), the CRM and L&B proxy cards singled out the individual company nominees that they opposed. The cards listed out all director nominees as required, but also indicated clearly the company nominees that the dissident deemed acceptable and those that the dissident opposed. We expect dissidents going forward to take a similar approach.

This focus on individual directors illustrates how clear disclosure regarding the strengths and skills of each company nominee is more critical than ever.

Proxy Advisory Firms (Most Likely ISS) Will Split Recommendations: ISS has also suggested a greater focus on individual nominees' qualifications, and has put the "weakest" candidates on notice. ISS's guidance surrounding the universal proxy rules specifically mentions the potential for replacement of a "long-tenured, over boarded director who seems disengaged" with "a nominee who brings clearly-relevant skills to the board, or perhaps enhances diversity." Thus, we expect proxy advisory firms, particularly ISS, (when each deems warranted) to issue recommendations supporting a mix of company and dissident nominees.

- This was the case in L&B's proxy contest against AIMCO. ISS split its recommendation—recommending for one of the two nominees of the dissident over one of the company nominees (identifying which company nominee it would swap out for which dissident nominee).

Proxy Advisory Firms' Recommendations Will Continue to Be a Key Factor in Success: ISS's guidance for assessing a dissident proxy campaign indicated that its two-prong framework would largely stay the same under the universal proxy regime: (1) is there a case for change and (2) if so, how much change? ISS did acknowledge that the universal proxy rules bring into sharper focus the second prong, as stockholders can now "more precisely adjust board composition" on an individual candidate basis—making it somewhat unsurprising that ISS split its recommendation in the L&B/AIMCO contest. AIMCO stockholders went on to elect the dissident nominee that ISS had recommended for over the company nominee that it had recommended against, in addition to the two company nominees that both ISS and Glass Lewis had recommended for. In the CRM/Argo contest, ISS stated that the dissident did not make a compelling case for change, and recommended that stockholders vote for all of the company's nominees.

Glass Lewis, on the other hand, seems to take a more holistic view with respect to a dissident's thesis for change. In both the L&B/AIMCO and CRM/Argo contests, Glass Lewis recommended in favor of all of the nominees of the respective companies. In the CRM/Argo contest, Glass Lewis stated in its proxy paper report that it is "reticent to recommend the removal of incumbent directors…unless certain issues are evident."

The outcomes of the L&B/AIMCO and CRM/Argo contests suggest that the recommendations of proxy advisory firms continue to be a key factor in determining who emerges successful in a proxy contest—the company or the dissident. In fact, shortly after ISS and Glass Lewis both recommended for all company nominees in CRM/Argo, CRM withdrew its director nominations—perhaps because it believed stockholders would generally vote in-line with the proxy advisory firms' recommendations.

Serious Dissidents Won't Cut Campaign Costs: Following the release of the universal proxy rules, there was much speculation over whether the rules would result in significantly cheaper proxy contests for all dissidents—because, among other reasons, dissidents are only required to solicit 67% of outstanding voting shares. However, recent examples indicate otherwise. In the L&B definitive proxy statement, L&B

estimated that its cost of solicitation of proxies in connection with its proxy contest at AIMCO was approximately $1 million and that as of the date of the filing, its expenses were approximately $200,000. Compare this to two of L&B's pre-universal proxy rule campaigns at other companies:

- In March of 2022, L&B disclosed in its definitive proxy statement that its estimated cost of solicitation in connection with its proxy contest at Ventas, Inc. was approximately $1.2 million and that at the time of the filing, its expenses were approximately $500,000.
- In April of 2018, L&B disclosed in its definitive proxy statement that its estimated cost of solicitation in connection with its proxy contest at Taubman Centers, Inc. was approximately $1.1 million and that at the time of the filing, its expenses were $100,000.

Of the three L&B campaigns discussed above, L&B won board representation in two of them (AIMCO and Taubman). While a pure "nuisance" dissident might behave differently, it appears that serious dissidents who are looking to win will spend amounts in-line with pre-universal proxy rule expenses.

Many Companies Have or Are Considering Amended Bylaw Provisions: Year-end 2022 saw a record high number of bylaw amendments made by companies in light of the universal proxy rules. Deal Point Data reported that 288 US companies made amendments to advance notice disclosure, eligibility requirements and timeliness requirements across November and December 2022, as compared to 13 companies that made changes to such provisions over the course of November and December 2021.

While some of these bylaw amendments seek to address ambiguity or close gaps created by the universal proxy rules (e.g., there is no stated enforcement mechanism in the event that a dissident does not comply with the rule's 67% solicitation threshold), others seek to more generally strengthen the company's defensive profile (e.g., requiring that a dissident request a director questionnaire from the company and include the completed questionnaire in its nomination notice or requiring that the dissident use a proxy card that is a color other than white (if the company has historically used a white card)). Companies should keep in mind that any such amendments should be implemented on a "clear day" and they should tread carefully when considering amendments that could be perceived as going far beyond the scope of what is required under the universal proxy rules.

- As of the date of this publication, there is a case pending in Delaware Chancery Court wherein a company (Masimo Corp.) was sued by a stockholder (Politan Capital Management LP) for adopting bylaw amendments the stockholder described as "perhaps the most preclusive advance notice bylaws in Delaware history" and that, among other things, would require any investment fund seeking to nominate a board candidate to disclose the identity and investment holdings of its limited partners. If the case goes to decision, it might provide further guidance on the court's view of advance notice bylaw boundaries.

Look Out for Additional Guidance from the SEC: On December 6, 2022, the staff of the Securities and Exchange Commission ("SEC") published three Compliance and Disclosure Interpretations ("CD&Is") regarding the universal proxy rules, which set forth the staff's positions that:

- If the company determines, in accordance with state or foreign law, that the dissident's nominations do not comply with the company's advance notice bylaw requirements, then the company can omit the dissident's nominees from its proxy card.
- If a company excludes a dissident's nominees from its proxy card due to the dissident's failure to comply with the company's advance notice bylaws and the dissident challenges this exclusion in court, then the company is required to disclose in its proxy statement certain information regarding the exclusion of the dissident's nominees (the CD&I enumerates the specific information that must be disclosed).
- A dissident cannot conduct a solicitation simply by filing a proxy statement and relying exclusively on the company's proxy card; the dissident must furnish its own proxy card in its solicitation. (Note: A dissident can use the Rule 14a-16 "notice and access" method, which requires the mailing of a notice of the internet availability of proxy materials and the posting of such materials on a website rather than printing and mailing a full set of materials.)

Spotlight on Risk Oversight: Director Duties and Disclosure

By: Martha McGarry, Andrew Noreuil and Camila Panama

Expectations surrounding the role of the board of directors in risk oversight have evolved. Delaware courts are entertaining more duty-of-oversight claims. The US Securities and Exchange Commission ("SEC") is calling for more fulsome risk-related disclosure. Here is what directors and public companies should keep in mind in 2023.

"Caremark" Takes a Turn: The seminal 1996 Delaware court case, *In re Caremark International Inc. Derivative Litigation*, has historically set the stage with respect to the legal standard for directors' risk oversight duties. In the *Caremark* line of cases, Delaware courts held that directors can be liable for a failure of board oversight only where there is "sustained or systematic failure of the board to exercise oversight," such as (i) an utter failure to implement any reporting system or controls, particularly of "mission-critical" functions or (ii) even when such a system or controls are in place, a conscious failure to oversee corporate operations, notably when presented with red flags of imminent problems. This presented a high bar to clear, and in the decades that followed, courts regularly dismissed stockholder suits claiming a total failure of oversight responsibility. However, recently, there have been a growing number of cases where *Caremark* claims survived motions to dismiss and were permitted to proceed against directors. Some key takeaways from these cases include:

- ***Good Record Keeping Is Important***. Meeting minutes should document the board's careful attention to risk oversight, including discussion of legal compliance matters applicable to the business and monitoring of other mission-critical functions.
- ***Consider a Risk Committee/Develop Risk Protocols***. A risk committee is not required, but if there is not one, there should be clear and documented protocols in place for who at the board level will monitor risk and how management will report any relevant issues to the board. For example, if there is no standalone risk committee, then it is advisable to have committee charters that reflect which board committees are responsible for monitoring risk. "Red flags" cannot simply be ignored.
- ***Trainings on Key Issues Can Help***. If there are particular areas of exposure or applicable emerging areas of risk (such as cyber-attacks), for which directors do not already have expertise or familiarity, it is important that directors develop a working knowledge of key issues. This can often be done by leveraging the expertise of management and outside advisors through training sessions.

Caremark claims, which allege violations of a director's fiduciary duty of loyalty that are not exculpable under a corporation's certificate of incorporation and may not be indemnifiable by the corporation, may create heightened pressure to settle should they survive a motion to dismiss.

The SEC Has Called for More Disclosure: In 2022, a number of public companies received a letter from the SEC asking for increased risk disclosure to be included in their future proxy statements. More specifically, many of the letters included requests such as: "*Please expand upon how your board administers its risk oversight function. For example, please disclose*":

- Why your board elected to retain risk oversight rather than assign oversight to a board committee.
- Whether you consult with outside advisors and experts to anticipate future threats and trends, and how often you re-assess your risk environment.
- The timeframe over which you evaluate risks and how you apply different standards based upon the immediacy of the risk assessed.
- Whether you have a Chief Compliance Officer and to whom this position reports.
- How your risk oversight process aligns with your disclosure controls and procedures.

The SEC has generally said that risk oversight disclosure has become too boilerplate to be helpful to stockholders, and that this needs to be remedied. The letter that included the above disclosure requests, for example, directed the company to refer to Item 407(h) of Regulation S-K for guidance (which Item requires disclosure regarding *Board leadership structure and role in risk oversight*). Thus, even if a company did not receive a letter specifically urging it to expand its risk oversight-related disclosure, it would be prudent to re-visit 407(h) of Regulation S-K and confirm that the company is addressing the disclosure requirements with sufficient specificity in its 2023 proxy statement and going forward.

Officer Exculpation: Delaware Updates and Approach to Charter Amendments

By: Martha McGarry, Andrew Noreuil, Camila Panama and Brian Massengill

The amendments to Section 102(b)(7) of the Delaware General Corporation Law ("DGCL") went into effect on August 1, 2022. As a result, corporations are now permitted to include an exculpation clause in their certificate of incorporation that eliminates or limits the personal liability of the corporation's senior officers for monetary damages for breaches of fiduciary duty—such exculpation was previously only permitted for directors, not officers. Below, we walk through key aspects of the DGCL amendment and how corporations are reacting to it.

Which Officers Can Be Covered: Officers that may be covered by the exculpation clause include:

• President	• Chief Accounting Officer
• Chief Executive Officer	• Controller
• Chief Operating Officer	• Treasurer
• Chief Financial Officer	• The corporation's "named executive officers" (generally, the three most highly compensated executive officers, aside from the principal executive and financial officers, as identified in SEC filings)
• Chief Legal Officer	• Other persons who have consented in writing to be identified as officers for service of process

There Are Exclusions: The protection afforded by the amendment includes the same carve-outs as those applicable to directors (i.e., does not apply to breaches of the duty of loyalty, acts or omissions not in good faith or that involve intentional misconduct or knowing violations of the law, or transactions in which officers receive improper personal benefits) and one additional exclusion: the protection does not apply to liability for claims brought against officers by, or in the right of, the corporation (i.e., derivative actions).

Approach to Charter Amendments: According to a *Deal Point Data* study, only 16 of the Russell 3000/S&P 1500 companies have proposed charter amendments to include officer exculpation as of the time of this publication, and of those proposals, half have passed, two have failed, and six are pending. This low number of amendment proposals is unsurprising given the August timing of the DGCL amendment—a majority of companies have not yet had their regularly scheduled annual stockholders' meeting, which would be the most likely time that such a proposal would be put to a vote. It is also notable that ISS and Glass Lewis' 2023 proxy voting guidelines were not yet in effect with respect to the proposals that have already gone to a stockholder vote to date. For companies considering the inclusion of such a charter amendment proposal in connection with their 2023 annual meeting, it is critical to understand the proxy advisory firms' views—which, are not in agreement.

- **ISS**: Will recommend proposals providing for officer exculpation provisions in a company's charter on a case-by-case basis, taking into account the stated rationale and other enumerated factors, such as the extent to which the proposal would:
    - Eliminate officers' liability for monetary damages for violating the duty of care and/or the duty of loyalty;
    - Expand coverage beyond legal expenses to liability for acts that are more serious violations of fiduciary obligations than mere carelessness; and
    - Expand the scope of indemnification to provide for mandatory indemnification of company officials in connection with acts for which the company was previously permitted (at the discretion of the board), but not required, to provide indemnification.
- **Glass Lewis**: Will evaluate proposals to adopt officer exculpation provisions in company charters on a case-by-case basis but will generally recommend against provisions that would eliminate monetary breaches of the duty of care for certain corporate officers unless there is a compelling rationale provided by the board of directors and the provisions are reasonable. No guidance on what would be considered "compelling" or "reasonable" was provided.

As companies venture to test the waters on officer exculpation charter amendments in the 2023 proxy season, we expect to get more clarity on how the proxy advisory firms are analyzing and making recommendations on these proposals.

New Guidance on the 1% Excise Tax on Stock Buy-Backs

By: Jason Bazar and Lucas Giardelli

On December 27, 2022, the US Treasury Department and the Internal Revenue Service ("IRS") issued Notice 2023-2 (the "Notice"), which provides taxpayers interim guidance on certain aspects relating to the new 1% excise tax on stock buy-backs. The 1% excise tax was enacted last summer as part of the Inflation Reduction Act and generally applies to any US corporation whose stock is traded on an established securities market and that "repurchases" more than $1 million of stock over the course of a tax year. Among other things, the Notice provides important clarifications relevant to common M&A and capital markets transactions.

- Acquisitions structured as tax-free reorganizations would be subject to the excise tax only to the extent of taxable cash or other non-stock property ("boot") paid in the reorganization (with an exception for payment of cash in lieu of fractional shares assuming certain requirements are met).
- Tax-free spin-offs and split-offs are excluded from the excise tax, except to the extent cash or "boot" is received as part of a non-pro rata split-off.
- Taxable acquisitions (e.g., an all-cash merger) would be treated as involving a "repurchase" subject to the excise tax to the extent the target (or a transitory merger sub that merges into the target in a reverse subsidiary merger) incurs debt to fund part of the merger consideration. Alternative structures where leverage is placed at the level of the acquiror company may avoid the tax.
- The Notice confirms in an example that redemption of mandatorily redeemable preferred stock may be subject to the excise tax (notably, even if the stock had been issued prior to the enactment of the Inflation Reduction Act). However, the Notice requests comments on whether special exceptions are warranted for preferred stock.
- The Notice provides that liquidations of corporations that are fully taxable under Section 331 of the Internal Revenue Code (the "Code") are not subject to the excise tax. It would appear this may protect from the tax dissolutions of special purpose acquisition companies ("SPACs"), but more clarity would be welcome on certain technical points.
- Even though the excise tax generally only applies to stock repurchases by US public companies, stock repurchases by non-US public companies may become subject to the excise tax if a US affiliate funds by any means such acquisition and the funding is undertaken for "a principal purpose of avoiding the stock repurchase excise tax." Notably, the principal purpose is deemed to exist if the repurchase occurs within two years of the funding by the US affiliate (other than a funding through distributions).

- The Notice provides guidance on the valuation of repurchased stock for the purpose of computing the excise tax base. The fair market value of the stock is determined by its market price on the date of repurchase. If the stock is traded on an established securities market, the market price is determined using one of four specified methods under the Notice. For the repurchase of non-traded stock of a public company, the market price is determined using principles under Code § 409A.
- The Notice clarifies certain aspects of the "netting rule," i.e., reduction of the excise tax base by the amount of stock issued by the corporation in the tax year. For example, restricted stock issued to employees is only treated as issued for purposes of the netting rule upon vesting or if the employee had filed an election under Code §83(b).

While the Notice provided welcome guidance, several important questions remain unanswered. The Notice requests comments on a number of these open issues including, for example, whether special rules should be provided for repurchases of options or other equity-linked financial instruments or for financially distressed companies.

For more details, see our Legal Update "1% Stock Buyback Tax: US Treasury, IRS Release Interim Guidance."

Stockholders’ Increased Use of Delaware Books and Records Demands and the Access to Electronic Records

By: Brian Massengill

Over the past several years, stockholders have increasingly used Section 220 of the Delaware General Corporation Law to seek access to books and records of Delaware corporations. This trend is due in part to Delaware courts strongly encouraging stockholders to use this tool to investigate potential wrongdoing prior to filing a lawsuit. These demands can prove burdensome if the company does not take care in communicating with its board and recording the board process and decision making.

Section 220 Books and Records Demands

Under Delaware law, a stockholder has a right to seek access to books and records of a Delaware corporation. To obtain access, the stockholder is required to assert a “proper purpose,” which can include investigating potential wrongdoing such as a mismanagement or fiduciary duty breaches. To establish “proper purpose,” the stockholder merely needs to show that there is a “credible basis” from which the court can infer there was possible mismanagement or breaches that would warrant further investigation. In recent decisions, the Delaware Supreme Court has clarified that this showing is a low bar under Delaware law.[2] As a result, Section 220 disputes now largely center around whether the stockholder can access electronic records such as emails and texts.

What Books and Records May Be Inspected

Whether the court will permit stockholder access to emails and other electronic communications could well depend on the robustness of the formal board-level records (e.g., minutes, presentations) relating to the matter being investigated. Do those materials actually contain the information the board received relating to the matter being investigated? Do the agendas and minutes evidence the board’s deliberations and decisions?

In contrast, if the formal board materials do not evidence the board’s deliberations and decision-making involving the matter being investigated, access to emails might be found to be necessary to the stockholder investigation. Where the evidence indicates that the company and the board communicated through informal channels and the deliberations were not confined to the board room, there is a greater risk the company will be required to search emails and text messages, including those of board members and senior executives.

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[2] *See, AmerisourceBergen Corp. v. Lebanon Cnty. Emps.’ Ret. Fund,* 243 A.3d 417 (Del. 2020) and *NVIDIA Corp. v. City of Westland Police and Fire Ret. Sys.,* 282 A.3d 1 (Del. 2022).

Given where Delaware law stands on the issue, there is little doubt that stockholders will seek access to such informal communications. The ability of the company to avoid or limit such access will largely depend on disciplined board practice and record keeping.

The importance of robust board minutes and materials will also impact the ability to defend against potential litigation. A recent Delaware Court of Chancery decision (*Goldstein v. Denner*, 2022 WL 1671006 (Del. Ch. May 26, 2022)) relating to a public company acquisition illustrates the interaction of board materials provided in response to a Section 220 demand and resulting breach of fiduciary duty litigation. The complaint focused in part on alleged discrepancies between the board minutes and materials and the disclosures in the background section of the Schedule 14D-9 sent to stockholders. The court ruled, for purposes of the motion to dismiss, that it was reasonably conceivable that updates to the board on the sale process that were disclosed in the background section did not occur because they were not reflected in the board minutes.

Key Takeaways

There are several key takeaways from the recent Delaware cases, that largely follow best practices for the board being informed regarding, and deliberating and deciding, significant corporate matters. As Section 220 demands primarily relate to the investigation of M&A transactions or potential *Caremark* claims relating to "mission-critical" risks, the formal board materials should reflect the board processes around these matters:

- The board agendas, decks and other materials should demonstrate the information the board received and considered.
- Informal communications to the board should be avoided or limited such that there is not a record of the board conducting its business through informal channels. Recognizing that the court may permit inspection of informal records, executives and directors should be reminded regularly to take care with deliberations outside the board room and discussions by email or text message.
- Board minutes should be detailed and document the board's deliberations and decisions regarding such matters. Summary minutes may not be sufficient to limit access to informal communications and may impact the ability of the company to defend against a lawsuit.

Contact Us

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