Paul | Weiss

CLIENT MEMORANDUM

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2023 Year-End U.S. Legal & Regulatory Developments

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The following is our summary of significant 2023 U.S. legal and regulatory developments of interest to Canadian companies and their advisors. The first section below covers key developments from the fourth quarter of 2023; the second section discusses certain key developments from the first three quarters of 2023.

Recent Developments (Fourth Quarter 2023)

1. Fifth Circuit Vacates SEC Share Repurchase Disclosure Rule

On December 19, 2023, the U.S. Court of Appeals for the Fifth Circuit vacated the United States Securities and Exchange Commission's (the "SEC") share repurchase disclosure rule, which would have required public companies to disclose their reasons for repurchasing shares, and to collect daily repurchase data and file it quarterly. The Fifth Circuit had previously held that the SEC's adoption of the rule violated the Administrative Procedure Act, and had remanded the matter to the SEC and directed it to correct the noted deficiencies within 30 days. The SEC initially asked for more time, and after that request was denied, advised the court that it was unable to address the deficiencies within the 30-day time period. As a result, issuers will not be required to comply with the rule's required disclosures in their upcoming reports – this includes not just share repurchase disclosures, but also disclosures about the entry by issuers into Rule 10b5-1 plans, as well as disclosures regarding trading by directors and executive officers within four business days of a share repurchase announcement.

For the full text of our memorandum, please see:

- https://www.paulweiss.com/media/3984140/fifth_circuit_vacates_sec_share_repurchase_disclosure_rule.pdf

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For the Fifth Circuit's opinion, please see:

- https://cases.justia.com/federal/appellate-courts/ca5/23-60255/23-60255-2023-12-19.pdf?ts=1703086350

For the SEC's vacated share repurchase disclosure rules, please see:

- https://www.sec.gov/files/rules/final/2023/34-97424.pdf

2. SEC Adopts Schedule 13D/G Amendments That Are Far Less Helpful to Investors than Originally Expected

On October 10, 2023, the SEC approved final amendments to Schedules 13D and 13G beneficial ownership reporting. The Schedule 13D/13G beneficial reporting regime is supposed to provide good information to market participants, but years ago was overtaken by changes in technology and trading dynamics that resulted in some highly material information never being disclosed (e.g., large long positions in the form of cash-settled derivatives) and other highly material information being disclosed after a very long delay (e.g., common stock positions that could be well in excess of 5% of a public company's market capitalization). After 19 months of studying the issue, the SEC has announced a series of largely inconsequential changes that do very little to correct the imbalance or tardiness with respect to disclosure of investments in public companies by activist hedge funds and similar market participants. The final rules are effective beginning February 5, 2024, except that (i) the revised Schedule 13G deadlines will apply starting September 30, 2024 and (ii) the requirement to file Schedules 13D and 13G in a new structured data, XML-based format will apply starting December 18, 2024.

Accelerated Filing Deadlines and Filing Format

Initial Schedule 13D filings will be due within five business days after crossing 5% beneficial ownership (down from ten calendar days), and amendments will be due within two business days of any material change (reflecting a codification of the SEC's current interpretation of the requirement to file amendments "promptly"). Initial Schedule 13G filings by qualified institutional investors and exempt investors will be due within 45 days of quarter-end (instead of 45 days after year-end). Initial Schedule 13G filings by passive investors will be due within five business days of crossing 5% beneficial ownership (down from ten calendar days). Amendments to all Schedule 13G filings will be due 45 calendar days after the quarter-end in which any material change occurs (instead of 45 days after year-end). To facilitate meeting these deadlines, the final rules extend the daily cutoff for Schedule 13D and 13G filings to 10:00 p.m. Eastern time (from 5:30 p.m. Eastern time) and define "business day" as any day (other than a Saturday, Sunday or federal holiday) from 12:00 a.m. to 11:59 p.m. Eastern time. Schedules 13D and 13G will ultimately have to be filed using an XML-based format, but only after September 30, 2024.

Derivative Securities

Beneficial ownership of securities underlying cash-settled swaps. The SEC did not amend Rule 13d-3 as it had proposed, to deem holders of non-security-based swap (SBS), cash-settled derivative securities to be the beneficial owners of the reference equity securities if held with the purpose or effect of changing or influencing the control of the issuer of the reference securities, or in connection with or as a participant in any transaction having such purpose or effect. Instead, the SEC issued guidance that beneficial ownership of the underlying reference equity security may exist where a cash-settled derivative security:

- confers, directly or indirectly, exclusive or shared voting or investment power over the reference security through a contractual term of the derivative security or otherwise;
- is acquired with the purpose or effect of divesting its holder of beneficial ownership of the reference security or preventing the vesting of beneficial ownership as part of a plan or scheme to evade Section 13(d) or 13(g) reporting requirements; or
- grants (i) a right to acquire beneficial ownership of the equity security within 60 days or (ii) a right to acquire beneficial ownership of the equity security with the purpose or effect of changing or influencing the control of the issuer of the security, or in connection with or as a participant in any transaction having such purpose or effect.

The SEC's adopting release notes that non-SBS derivative securities settled exclusively in cash generally are designed to represent only an economic interest, but "discrete facts and circumstances" could confer beneficial ownership of the underlying reference security. Given this, typical cash-settled swaps without an option to settle in kind (commonly used by activists to build positions in target companies) will likely remain outside the calculation of beneficial ownership.

Disclosure of all derivative securities position on Schedule 13D. The final rules revise Item 6 of Schedule 13D, as was proposed, to clarify that beneficial owners must disclose interests in all derivative securities that use the company's equity security as a reference security, including cash-settled derivative securities and securities-based swaps, whether or not originated, offered or sold by the company. Item 6 of Schedule 13D previously only explicitly referred to puts or calls.

Groups

Group formation based on concerted action. The SEC chose not to adopt most of its proposed amendments to Rule 13d-5, including removing the reference that persons must "agree" to act together to form a group. Instead, the SEC issued guidance that under its existing rules an express agreement is not necessary to find that a group exists and that such determination should be a facts-and-circumstances analysis of whether two or more persons act together for the purpose of "acquiring," "holding" or "disposing of" securities of a company. The SEC confirmed that some minimum indicia of agreement (such as an informal arrangement or coordination) were needed to form a group.

In addition, to address concerns that even the SEC's proposal could chill shareholder engagement, the SEC issued a series of Q&As articulating the general concept that shareholder communication and engagement involving an exchange of ideas and views (alone and without more) would not form a group.

Trading on "tipping" of a potential Schedule 13D filing. The SEC did not adopt proposed amendments that would deem a group to exist where a Schedule 13D filer shares non-public information about an upcoming filing with the purpose of causing the tippee to make, and the tippee makes, purchases based on that information. The SEC instead issued a Q&A to this same effect, stating that if a blockholder that is required to file a Schedule 13D (or amendment) intentionally communicates to other market participants that such a filing will be made (to the extent this information is not public) with the purpose of causing others to make purchases in the same covered class of securities, and purchases were made as a direct result of the blockholder's information, these activities raise the possibility that all of such beneficial owners are a group.

Technical amendments regarding group ownership of securities. The final rules include technical revisions (mostly in line with the proposed rules) to clarify that a group acquires any securities acquired by a member of the group after its formation, and that intra-group transfers would not constitute an additional acquisition by the group.

For the full text of our memorandum, please see:

- https://www.paulweiss.com/media/3983834/sec_adopts_schedule_13g_amendments_that_are_far_less_helpful_to_investors_than_originally_expected.pdf

For the SEC's final rules, please see:

- https://www.sec.gov/files/rules/final/2023/33-11253.pdf

3. New Filing Requirements Under the Corporate Transparency Act

On January 1, 2024, the Beneficial Ownership Reporting Rule (as defined below) under the Corporate Transparency Act (the "CTA") went into effect. The Beneficial Ownership Reporting Rule requires certain non-exempt entities to disclose previously unrequired information or face potential civil and criminal penalties.

Overview
In September 2022, the U.S. Department of the Treasury's Financial Crimes Enforcement Network ("FinCEN") issued a final rule (the "Beneficial Ownership Reporting Rule") implementing Section 6403 of the CTA. The Beneficial Ownership Reporting Rule requires "Reporting Companies," as defined by the CTA—generally legal entities formed or registered to do business in the United States that do not fall into one of the CTA's enumerated exemptions—to file Beneficial Ownership Information with FinCEN. "Beneficial Ownership Information" includes basic information about the legal entity (e.g., address) and information about the entity's Company Applicants and/or Beneficial Owners (each as defined below).

When does the Beneficial Ownership Reporting Rule go into effect?
Reporting Companies registered before January 1, 2024 have until January 1, 2025 to file their initial Beneficial Ownership Information reports. Reporting Companies registered on or after January 1, 2024 but before January 1, 2025 must file their reports within 90 days after receiving notice of their creation or registration. Reporting Companies created on or after January 1, 2025 must file their reports within 30 days after receiving notice of their creation or registration. After filing, Reporting Companies have 30 days to report changes, updates or corrections to previously submitted information regarding the Reporting Company or its Beneficial Owners.

Members of Congress have made certain legislative proposals that, if adopted, would adjust the Beneficial Ownership Reporting Rule timelines. As of the date of this memorandum, such proposals have not been adopted. In June 2023, the Protecting Small Business Information Act was introduced, which, if enacted, would indefinitely delay the effectiveness of the Beneficial Ownership Reporting Rule until FinCEN finalizes certain other rules that must be implemented pursuant to the CTA. On December 22, 2023, FinCEN published its final rule (the "Access Rule") regarding the circumstances under which certain governmental entities will have access to Beneficial Ownership Information collected pursuant to the Beneficial Ownership Reporting Rule. The Access Rule (i) limits access to Beneficial Ownership Information to federal agencies engaged in national security, intelligence or law enforcement activities; state, local and tribal law enforcement agencies with court authorization; financial institutions with customer due diligence requirements (and regulators supervising them for compliance with such requirements); foreign law enforcement agencies, prosecutors, judges and other agencies that meet specific criteria; and Treasury officers and employees under certain circumstances and (ii) sets security and confidentiality standards for protecting Beneficial Ownership Information consistent with the goals and requirements of the CTA.

What are "Reporting Companies" under the CTA?
A "Reporting Company," as defined by the CTA, is any domestic or foreign entity that is a corporation, limited liability company or "similar entity" that is created by the filing of a document with a secretary of state or similar office. A key factor in determining whether a company will be a Reporting Company is whether it had to file a document with its secretary of state, or similar office, in order to create the company or, for foreign companies, register to do business in the United States.

Are there any exemptions to the definition of Reporting Company?
Yes, the CTA exempts 23 types of entities from the Reporting Company definition, including: securities reporting issuers; large operating companies; registered investment companies and certain registered investment advisers; venture capital fund advisers; certain pooled investment vehicles ("PIVs"); and certain subsidiaries of exempt companies (excluding, for example, subsidiaries of exempt PIVs, each as defined in the CTA).

If a company is not exempt, what type of information must it file?
Each Reporting Company must submit its full legal entity name (as well as any trade or d/b/a names), address of its principal place of business, jurisdiction of formation (or, for foreign Reporting Companies, the jurisdiction where such Reporting Company first registers) and a unique identifying number (generally, the employer identification number or other taxpayer identification number issued by the IRS ("TIN") or, in the case of foreign Reporting Companies, a foreign tax identification number).

Reporting Companies must also identify and file basic information such as the full legal name, date of birth, business street address or current residential street address (as applicable) and a unique identifying number from an acceptable identification

document (together with an image of the identifying document) for Beneficial Owners and Company Applicants (as defined below).

- "Beneficial Owner" is a broadly defined category and includes individuals who directly or indirectly (i) exercise substantial control or (ii) own or control at least 25% of the ownership interests of a Reporting Company.
  - Exercising substantial control includes serving as a senior officer of the company and having substantial influence over important decisions such as compensation schemes, business lines and major transactions such as mergers.
  - "Ownership interest" is defined broadly and includes direct and indirect interests.
- For a domestic Reporting Company, a "Company Applicant" is any individual who files the document that creates the entity or is primarily responsible for directing or controlling such filing. For a foreign Reporting Company, a "Company Applicant" is any individual who files the document that first registers the entity to do business in the United States.
  - Only Reporting Companies created after January 1, 2024 must report Company Applicant information.
  - There can be up to two individuals who qualify as Company Applicants: (i) the individual who directly files the document that creates or first registers the Reporting Company; and (ii) the individual who is primarily responsible for directing or controlling the filing of the relevant document.

Is there a way to make this filing requirement less burdensome?
Yes, FinCEN is currently creating a process for individuals and companies to obtain a unique FinCEN identifying number, separate from already existing unique identifiers such as the TIN, which, for individuals, can be used in lieu of filing the above information for the creation of new entities and any future filings or updates.

What are the penalties for noncompliance?
Willful reporting violations of the Beneficial Ownership Reporting Rule can result in civil and criminal penalties, including fines of $500 per day (up to a maximum of $10,000) and imprisonment for not more than two years. There are also civil and criminal penalties for the unauthorized disclosure or access of Beneficial Ownership Information.

How will FinCEN protect Beneficial Ownership Information provided by Reporting Companies?
FinCEN is currently developing procedures to govern the access and protection of Beneficial Ownership Information. FinCEN has assured prospective Reporting Companies that the system will comply with federal data privacy laws and is also developing a new IT system to protect the information.

For the full text of our memorandum, please see:

- https://www.paulweiss.com/media/3984023/new_filing_requirements_under_the_corporate_transparency_act.pdf

For the text of the Beneficial Ownership Reporting Rule, please see:

- https://www.govinfo.gov/content/pkg/FR-2022-09-30/pdf/2022-21020.pdf

For the text of the Beneficial Ownership Reporting Rule deadline extension for companies created in 2024, please see:

- https://www.govinfo.gov/content/pkg/FR-2023-11-30/pdf/2023-26399.pdf

For the text of the Access Rule, please see:

- www.federalregister.gov/documents/2023/12/22/2023-27973/beneficial-ownership-information-access-and-safeguards

4. SEC Adopts Share Lending Disclosure Rules

On October 13, 2023, the SEC adopted new Rule 10c-1a under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), which will require disclosure to a registered national securities association ("RNSA") of specified details regarding securities loans on a same day basis. The RNSA will then publish certain information regarding such loans. Rule 10c-1a became effective on January 2, 2024, and disclosure will be required beginning January 2, 2026.

Who will be required to disclose share lending activity?

Under new Rule 10c-1a, securities loan intermediaries or, where there are none, lenders themselves, and brokers and dealers where borrowing fully paid or excess margin securities, must disclose any loan of "reportable securities." "Reportable securities" are defined as any security or class of an issuer's securities for which information is reported or required to be reported to the consolidated audit trail pursuant to the CAT NMS Plan, the Financial Industry Regulatory Authority's Trade Reporting and Compliance Engine or the Municipal Securities Rulemaking Board's Real-Time Transaction Reporting System (or any reporting system that replaces one of these systems). The disclosure requirements do not attach to the use of margin securities by a broker or dealer unless the broker or dealer lends such margin securities to another person.

There are no reporting thresholds – all loans will trigger the disclosure requirement.

What information must be provided?

Information that must be disclosed and that the RNSA will publicize includes the legal name of the issuer and securities to be borrowed; the ticker symbol of those securities; the time and date of the covered securities loan; the name of the platform or venue; the amount of reportable securities loaned; rates, fees, charges and rebates for the loan; the type of collateral provided for the covered securities loan and the percentage of the collateral to the value of the reportable securities loaned; the termination date of the covered securities loaned; and the borrower type.

Information that must be disclosed and that the RNSA will not make public includes the legal names of the parties to the loan; when the lender is a broker-dealer, whether the security loaned to its customer is loaned from the broker-dealer's inventory; and whether the loan will be used to close out a fail to deliver pursuant to Rule 204 of Regulation SHO or whether the loan is being used to close out a fail to deliver outside of Regulation SHO.

Modifications to any of these terms will also need to be communicated on a same day basis.

When must the information be reported?

Loan participants must provide this information on a same day basis to the RNSA. The RNSA must publicize the required information by morning of the following business day, except for the amount of the loan, which must be publicized by the 20th business day. The RNSA must also publicize aggregate transaction activity and distribution of loan rates for those securities it determines appropriate.

When will these disclosure requirements become effective?

Rule 10c-1a became effective on January 2, 2024. Rules to implement Rule 10c-1a must be proposed by the RNSA within four months of January 2, 2024, and must become effective no later than January 2, 2025. Disclosure will be required starting on January 2, 2026 (the "reporting date"), and the RNSA must make specified information publicly available within 90 calendar days of the reporting date.

For the full text of our memorandum, please see:

- https://www.paulweiss.com/media/3983876/sec_adopts_share_lending_disclosure_rules.pdf

For the SEC's final rules, please see:

- https://www.sec.gov/files/rules/final/2023/34-98737.pdf

5. SEC Adopts Short Sale Disclosure Rules

On October 13, 2023, the SEC adopted new Rule 13f-2 under the Exchange Act which will require institutional investment managers to confidentially disclose their short positions and net monthly activity in equity securities to the SEC monthly on new Form SHO. Based on these reports, the SEC will then publish, on an aggregated basis per security, the gross short position and net activity. The new rules became effective on January 2, 2024, and compliance will be required commencing January 2, 2025.

Who must file these disclosures?

Pursuant to new Rule 13f-2, institutional investment managers, which Section 13(f)(6)(A) of the Exchange Act defines broadly to include any person, other than a natural person, investing in or buying and selling securities for its own account, and any person exercising investment discretion with respect to the account of any other person, will be required to file Form SHO if they meet either of the short position thresholds described below:

- if the equity security is registered pursuant to Section 12 of the Exchange Act, or the issuer of the equity security is subject to Section 15(d) of the Exchange Act (defined as "reporting company issuers"), and the institutional investment manager has a monthly average of daily short gross positions, as of market close of

  − $10 million or more, or

  − 2.5% or more of the issuer's outstanding shares; or

- for all other equity securities, if the institutional investment manager has a gross short position in excess of $500,000 or more at market close on any settlement date during the month.

What must be disclosed on Form SHO?

In addition to certain identifying information about the filing institutional investment manager and the issuer(s) of any reported equity securities, Form SHO must include, for each equity security required to be reported (per the reporting thresholds described above):

- the gross short position as of the last settlement date of the calendar month (both the number of shares of the short position as well as the corresponding U.S. dollar value must be reported); and

- the net activity in the security for each individual settlement date during the calendar month.

When and how must it be filed?

Form SHO must be filed via EDGAR within 14 calendar days after the end of each calendar month.

Will the information provided on Form SHO be confidential?

Yes, the SEC has explicitly stated the information filed on Form SHO will be deemed subject to a confidential treatment request. The SEC will, however, publish, on an aggregated basis (across all institutional investment managers, without naming any), the gross short position and net daily activity in reported securities within one month after the end of the reporting calendar month.

For the full text of our memorandum, please see:

- https://www.paulweiss.com/media/3983875/sec_adopts_short_sale_disclosure_rules.pdf

For the SEC's final rules, please see:

- https://www.sec.gov/files/rules/final/2023/34-98738.pdf

6. The DOJ, FBI Release Guidance Regarding New Form 8-K Cybersecurity Incident Reporting Requirements

As discussed below in the entry entitled "SEC Adopts New Cybersecurity Disclosure Requirements," on July 26, 2023, the SEC adopted amendments to Form 8-K to add new Item 1.05, which requires public companies to disclose certain information regarding any material cybersecurity incident within four business days of an assessment that the incident is material. The SEC also adopted amendments to Form 6-K requiring foreign private issuers to disclose material cybersecurity incidents. Item 1.05(c) permits affected entities to delay making the Form 8-K filing where the U.S. Attorney General determines that disclosure of the event would pose a "significant threat to public safety or national security." On December 12, 2023, the United States Department of Justice (the "DOJ") released a memorandum that outlines the approach the DOJ will take in determining whether a required disclosure poses such a risk, highlighting the "[l]imited circumstances for finding a substantial risk to national security or public safety" (the "DOJ Memo"). The DOJ Memo followed separate guidance released by the Federal Bureau of Investigation (the "FBI") on December 6, 2023, regarding the process by which victim companies can request a determination whether delayed disclosure is appropriate (the "FBI Guidance"). The DOJ Memo makes clear that entities that are victims of a cybersecurity incident which they believe may qualify for delayed disclosure should act promptly to request delayed disclosure, as neither the request nor the government's consideration of the request will toll the four business day period for the Form 8-K filing.

Takeaways

- A determination that a company may delay public disclosure of a material cybersecurity incident will be rare, absent facts that fall within the narrow circumstances implicating national security or public safety described in the DOJ Memo and FBI Guidance. Although the exemption is narrow, there will be circumstances such as incidents involving zero day vulnerabilities where delay may be appropriate, but companies will need to work quickly and in close coordination with the FBI for such delay to be available.

- The FBI Guidance underscores the benefits of early outreach to the FBI before a company determines that an incident is material. Merely consulting with the FBI will not result in a determination that an incident is material. In addition to other support that law enforcement can provide to victim organizations, early engagement allows the FBI to familiarize itself with the facts and circumstances of an incident and may enable it to more quickly review a later request for disclosure delay.

- Requests for delay may also be routed through other federal agencies. Although companies may initially contact the Cybersecurity and Infrastructure Security Agency, the U.S. Secret Service or other law enforcement agencies—and these agencies may have other unique support to offer victims—all requests for delayed Item 1.05 of Form 8-K disclosure will ultimately be routed through the FBI for assessment and a determination by the U.S. Attorney General.

These new disclosure requirements do not apply to Canadian multijurisdictional disclosure system ("MJDS") filers who file annual reports on Form 40-F.

For more information on Item 1.05 of Form 8-K, please see the entry entitled "SEC Adopts New Cybersecurity Disclosure Requirements" below.

For the full text of our memorandum, please see:

- https://www.paulweiss.com/media/3984121/the_doj_fbi_release_guidance_regarding_new_form_8k_cybersecurity_incident_reporting_requirements.pdf

For the DOJ Memo, please see:

- https://www.justice.gov/media/1328226/dl?inline

For the FBI Guidance, please see:

- https://www.fbi.gov/file-repository/fbi-policy-notice-120623.pdf/view

7. DOJ and FTC Issue Final 2023 Merger Guidelines

On December 18, 2023, the DOJ and the Federal Trade Commission (the "FTC") issued the final 2023 Merger Guidelines. These guidelines replace the 2010 Horizontal Merger Guidelines and the 2020 Vertical Merger Guidelines. The new guidelines are a substantial departure from the prior guidelines in a number of respects. Perhaps the most significant change is that the guidelines lower the threshold market concentration level at which the agencies would presume a merger to be illegal. The new guidelines also include a new presumption that a merger resulting in the merged firm having a market share greater than 30% would be illegal if it also resulted in a relatively modest increase in market concentration. Another new guideline states that the agencies will "seek to prevent those mergers that would entrench or extend a dominant position through exclusionary conduct, weakening competitive constraints, or otherwise harming the competitive process."

The federal antitrust analysis of mergers is generally governed by Section 7 of the Clayton Act, which prohibits acquisitions the effect of which "may be substantially to lessen competition, or to tend to create a monopoly." The agencies' merger guidelines do not have the force of law and are not binding on courts, though prior merger guidelines have been cited favorably in a number of litigated merger cases. Rather, the guidelines "identify the procedures and enforcement practices" the DOJ and FTC "most often use to investigate whether mergers violate the antitrust laws." Unlike previous versions, the new guidelines cite case law "to explain core principles that the Agencies apply in a manner consistent with modern analytical tools and market realities." However, much of the case law cited is decades old and the agencies explicitly state that they would "not necessarily . . . analyze the facts in those cases identically today."

Notable changes from prior guidelines

Lower threshold for presumed illegality of horizontal mergers. Both the prior and new guidelines contain a presumption that a merger is illegal if it increases market concentration above a certain threshold. Market concentration is usually measured using the Herfindahl-Hirschman Index ("HHI"). HHI is calculated by adding together the squares of the market shares of the firms in the relevant market. The higher the HHI, the higher the market concentration, and a market with only one firm would have an HHI of 10,000. The prior guidelines identified two categories of mergers that "often warrant scrutiny": those in "moderately concentrated markets" with an HHI between 1,500 and 2,500 where the merger would result in an HHI increase of more than 100; and those in "highly concentrated markets" with an HHI above 2,500 where the merger would result in an HHI increase of between 100 and 200. If a merger in a highly concentrated market would result in an HHI increase of more than 200, the prior guidelines presume that the merger would "be likely to enhance market power."

By contrast, under new Guideline 1, the agencies presume a merger to be illegal if it results in a post-merger HHI greater than 1,800, with a change greater than 100. This was the threshold found in the merger guidelines in effect from 1982 to 2010. The new guidelines also state that a merger that results in an HHI increase of greater than 100 and a firm with greater than 30% market share is presumed to be illegal. This metric was not in the prior guidelines. The 30% figure is from a 1963 Supreme Court case, *United States* v. *Philadelphia National Bank*. Specifically, when a merger exceeds either of these thresholds, the agencies will presume that the effect of the merger "may be to eliminate substantial competition between the merging parties and may

be to increase coordination among the remaining competitors after the merger" and therefore that the merger is illegal. The consequence of these new thresholds is that more deals are likely to be presumed illegal by the agencies, requiring the merging parties to submit evidence and argument to "rebut or disprove" the presumption.

If market shares are "difficult to measure," the guidelines state that the agencies "may instead measure market concentration using the number of significant competitors in the market." The guidelines do not indicate the number of "significant competitors" that would constitute a concentrated market.

Mergers involving dominant firms. New Guideline 6 states that a merger violates the Clayton Act if it "may entrench or extend an already dominant position." The concept of dominance does not have a defined meaning in existing U.S. antitrust law, however, and the guidelines do not provide much clarity. According to the guidelines, a determination that a firm has a dominant position is "based on direct evidence or market shares showing durable market power." Yet the guidelines do not give examples of what constitutes direct evidence of a dominant position, nor do they define what level of market share constitutes "durable market power."

The guidelines do cite a 1967 Supreme Court case, *FTC* v. *Procter & Gamble Co.*, in which the Court wrote that "at least 39%" of the "share of sales" of household liquid bleach in certain "regions" of the country was a "dominate [sic] position." In various contexts, courts have found that for a firm to have market power it must have a market share of at least 30%. Both of these figures are well below market shares typically associated with monopoly power. Therefore, it would appear that under the new guidelines, firms that fall well short of having monopoly power could be labeled "dominant" by the agencies and face challenges to their mergers as a result.

If a merging firm is "dominant," the agencies will ask whether the "merger may raise barriers to entry or competition," involves an acquisition of a firm posing a "nascent threat" to the acquirer, or "enable[s] the merged firm to extend a dominant position from one market into a related market." According to the guidelines, one way in which a firm might extend a dominant position from one market into a related market is by engaging in tying or bundling. (We note that courts have long held that such conduct, depending on the circumstances, may be lawful and procompetitive.)

Mergers in industries undergoing a trend toward consolidation. New Guideline 7 states that the "recent history and likely trajectory of an industry can be an important consideration when assessing whether a merger presents a threat to competition" and therefore the agencies will "examine whether a trend toward consolidation in an industry would heighten . . . competition concerns" identified in other guidelines, including, for example, making new entry less likely. Notably, the final guideline differs considerably from the draft version, which asserted that a merger that "contributes to a trend toward concentration" could itself be an antitrust violation rather than simply a factor that compounds competitive concerns already identified elsewhere in the guidelines.

Similarities with the prior guidelines

Several of the new guidelines retain and expand upon several concepts found in the prior guidelines.

Competition between the merging firms as measure of harm. Both the prior and new guidelines outline how the agencies may look at the degree of competition between the merging firms to predict whether a merger may substantially lessen competition. The prior guidelines stated that when a merger eliminated "substantial" competition between the merging firms, the merger could have adverse competitive effects. New Guideline 2 states that "if evidence demonstrates substantial competition between the merging parties prior to the merger, that ordinarily suggests that the merger may substantially lessen competition." The new guidelines list a "variety of indicators to identify substantial competition," including evidence that the two firms make strategic decisions in the ordinary course of business with reference to each other, evidence that there is customer substitution between the firms and evidence of "competitive actions by one of the merging firms" impacting the other merging firm.

Increase in risk of coordination as competitive harm. The prior guidelines recognized that certain mergers could harm competition "by enabling or encouraging post-merger coordinated interaction among firms in the relevant market." According to new Guideline 3, "a merger may substantially lessen competition when it meaningfully increases the risk of coordination among the remaining firms in a relevant market or makes existing coordination more stable or effective." If the market is highly concentrated, there has been a history of attempted or actual coordination or if a "maverick" firm is being eliminated, the agencies "may conclude that post-merger market conditions are susceptible to coordinated interaction." Other potential factors include whether "a firm's behavior can be promptly and easily observed by its rivals"; whether "a firm's prospective competitive reward from attracting customers away from its rivals will be significantly diminished by its rivals' likely responses" (which would "reduce the benefits of competing more aggressively" and render a market "more susceptible to coordination"); and whether coordination among the firms in a market would be "profitable or otherwise advantageous." Mergers that increase the risk of coordination are also dealt with in new Guideline 5, discussed below.

Harms to potential competition. New Guideline 4 states that "[m]ergers can substantially lessen competition by eliminating a potential entrant," noting that the harm is greater in more concentrated markets. The guideline recognizes that harm could arise in two ways. The first is by the elimination of an "actual potential" entrant where one of the merging firms "had a reasonable probability of entering the relevant market" and the entry had "a substantial likelihood" of deconcentrating the market "or other significant procompetitive effects." The second is by the elimination of a "perceived potential" entrant, that is, a "a firm that is perceived by market participants as a potential entrant." (Notably, these theories of harm to potential competition were asserted by the FTC in its challenge to the Meta-Within deal. The court in that case accepted that harms to potential competition could violate the Clayton Act, but found that the FTC failed to establish that it was likely to succeed on the merits in light of the evidence presented.) The prior guidelines also recognized that a "merger between an incumbent and a potential entrant can raise significant competitive concerns," but did not provide as much detail regarding harms to potential competition as the new guidelines—and did not include a discussion of actual potential versus perceived potential competition.

Mergers resulting in harms to rivals (including vertical mergers). The prior Vertical Merger Guidelines described a theory of competitive harm from raising rival's costs. This could arise when a merged firm had "control" of a "related product" and used this control to weaken an actual or potential rival. ("Related product" was defined as "a product or service that is supplied or controlled by the merged firm and is positioned vertically or is complementary to the products and services in the relevant market" being analyzed, such as "an input, a means of distribution, access to a set of customers, or a complement.")

New Guideline 5 sets out a similar, and somewhat broader, theory of competitive harm: "a merger may substantially lessen competition when the merged firm can limit access" to (as opposed to control) a "related product." ("Related product" is now defined as a "any product, service, or route to market that [a merged firm's] rivals use to compete in that market.") According to the guidelines, competition could be harmed not only by actually limiting access to a related product, but also by the mere threat of limited access because the threat "can deter rivals and potential rivals from investing." The guidelines identify several ways a merged firm could limit access short of an outright denial, including by degrading quality and limiting interoperability. Whereas the prior Vertical Merger Guidelines were concerned about control over products in a vertical or complementary relationship, new Guideline 5 is concerned about limiting access "to any products, services, or routes to market that rivals use to compete, and that are competitively significant to those rivals, whether or not they involve a traditional vertical relationship such as a supplier and distributor relationship."

The guidelines provide examples of several different types of related products that could raise concerns if a firm were able to limit access to them: "products rivals currently or may in the future use as inputs, products that provide distribution services for rivals or otherwise influence customers' purchase decisions . . . or complements that increase the value of rivals' products." The guidelines note that "[e]ven if the related product is not currently being used by rivals, it might be competitively significant because, for example, its availability enables rivals to obtain better terms from other providers in negotiations."

In evaluating the risk of whether a merged firm would limit access to rivals, the guidelines look at the firm's ability and incentive to do so and take into account several factors ranging from the availability of substitute products to the existence of barriers to

entry to a firm's prior actions to limit its rivals' access to the relevant product. The agencies will also look at "market structure" to evaluate a firm's ability to limit access. According to the guidelines, a merged firm will have the ability to harm competition by limiting access if it "is approaching or has monopoly power over the related product." The guidelines state that the agencies "will generally infer, in the absence of countervailing evidence, that the merging firm has or is approaching monopoly power in the related product if it has a share greater than 50% of the related product market." However, a "merger involving a related product with share of less than 50% may still substantially lessen competition, particularly when that related product is important to its trading partners."

According to the guidelines, "the Agencies are unlikely to credit claims or commitments to protect or otherwise avoid weakening the merged firm's rivals that do not align with the firm's incentives." This is notable in light of recent losses by the agencies involving challenges to vertical merger where courts found that commitments made by the merging parties sufficiently addressed competitive concerns.

Guideline 5 also (incongruously) states that a merger could harm competition if it allows the merged firm to "gain or increase access to rivals' competitively sensitive information, thereby facilitating coordination or undermining their incentives to compete." Therefore, according to the guidelines, the acquisition of "products that provide or increase the merged firm's access to competitively sensitive information about its rivals" is cause for concern.

The new guidelines also address specific scenarios, including serial acquisitions, multi-sided platforms, mergers involving buyer-side power and the acquisition of partial ownership.

For the full text of our memorandum, please see:

- https://www.paulweiss.com/media/3984122/doj_and_ftc_issue_final_2023_merger_guidelines.pdf

For the DOJ and FTC guidelines, please see:

- https://www.justice.gov/d9/2023-12/2023%20Merger%20Guidelines.pdf

8. Fifth Circuit Accepts Vertical Harm Theory and Establishes Standard for Evaluating Merger Fixes

On December 15, 2023, the United States Court of Appeals for the Fifth Circuit issued its opinion in *Illumina, Inc.* v. *FTC* ("*Illumina*"), an appeal from a decision of the FTC finding that Illumina's acquisition of Grail may substantially lessen competition in violation of Section 7 of the Clayton Act and ordering Illumina to divest Grail. The court rejected constitutional challenges raised by Illumina as "foreclosed by Supreme Court authority" and found that "substantial evidence" supported the FTC's factual findings. However, the court vacated and remanded the FTC's order because it found that the FTC had "applied an erroneous legal standard" in evaluating the parties' deal "fix."

Background

In March 2021, the FTC filed an administrative complaint seeking to block Illumina's vertical acquisition of Grail. At the time, Illumina owned 14.5 percent of Grail's voting shares and proposed to acquire the remainder. Illumina closed the transaction in August 2021 while the administrative proceeding was pending.

Grail developed a multi-cancer early detection (MCED) test that relies on "next-generation" DNA sequencing (NGS) platforms sold by Illumina. In its complaint, the FTC alleged that Illumina is "a dominant provider of NGS platforms," Grail and its competitors "have no substitutes for Illumina's NGS platforms," and the acquisition would harm competition in the market for "the research, development, and commercialization of MCED tests in the United States." Specifically, the FTC alleged that "Illumina will gain the incentive to foreclose or disadvantage firms that pose a significant competitive threat to Grail and to limit the competitiveness of any MCED product" and, as a result, "Illumina will control the fate of every potential rival to Grail for the foreseeable future."

In an attempt to address the FTC's challenge, after the litigation commenced, Illumina announced that it was "irrevocably offering" a standard 12-year NGS supply contract providing for "guaranteed access to the latest sequencing products," "no price increases for the sequencing products covered by the agreement" and "guaranteed lower pricing for the sequencing products by 2025." Citing this "Open Offer," among other things, the FTC administrative law judge concluded in September 2022 that FTC complaint counsel "failed to prove its asserted prima facie case that Illumina's post-Acquisition ability and incentive to advantage Grail to the disadvantage of Grail's alleged rivals is likely to result in a substantial lessening of competition in the relevant market for the research, development, and commercialization of MCED tests."

FTC complaint counsel appealed the decision to the commissioners, who conducted a *de novo* review of the initial decision's findings of fact and conclusions of law. The FTC, in an opinion authored by Chair Lina M. Khan, reversed the initial decision. Then-Commissioner Christine S. Wilson issued a concurring opinion. The FTC found that complaint counsel established its prima facie case by proving that Illumina had the ability to harm MCED test developers given its position as "the dominant provider of NGS," and the acquisition increased its incentive to do so. Among other things, after the merger, "Illumina will directly benefit from tilting the innovation race in favor of Grail, the MCED provider that it now 100% owns" because it will now earn margin on the sale of Grail tests. The FTC also found that respondents failed to rebut the prima facie showing with the Open Offer. The majority of the FTC characterized the Open Offer as a proposed remedy that "would need to foresee and foreclose all possible ways Illumina could harm GRAIL's competitors," but failed to do so in a number of ways. Illumina, which could have sought review of the FTC's decision in any federal circuit where it "resides or carries on business," filed a petition for review with the Fifth Circuit.

The Fifth Circuit's Opinion

Constitutional issues. The Fifth Circuit addressed and rejected each of Illumina's four constitutional challenges to the FTC's decision.

First, the court rejected Illumina's argument that the FTC's decision resulted from an unconstitutional delegation of legislative power allowing the FTC to decide whether to bring an enforcement action either in federal or administrative court without providing guidance on how to make the decision. The court found, however, that the types of actions the FTC can bring in federal court (actions for injunctive relief) differ from those that must be brought in administrative court (actions for "other forms of relief, such as monetary damages"). The court also found that a "public interest" standard – such as the standard for when FTC should initiate an enforcement action – has many times been upheld by the Supreme Court as an "intelligible principle."

Second, the court rejected Illumina's argument that the "FTC unconstitutionally exercised executive powers while insulated from presidential removal in violation of Article II." The court cited *Humphrey's Executor* v. *United States*, in which the Supreme Court "held that the FTC's enabling act did not run afoul of Article II because, essentially, the FTC was vested with quasi-legislative/quasi-judicial authority rather than purely executive authority."

Third, the court rejected Illumina's argument that its due process rights were violated when the FTC acted as both prosecutor and judge because "the Supreme Court has held that administrative agencies can, and often do investigate, prosecute, and adjudicate rights without violating due process."

Fourth, the court rejected Illumina's argument that its equal protection rights were violated "because there is no rational basis for allocating certain antitrust enforcement actions to the FTC and others to the" DOJ. The court held that the "interagency clearance process which allocates antitrust investigations" between the FTC and the DOJ "based primarily on which agency has expertise in the particular industry or market" involved was "undoubtedly a rational basis for giving one agency the lead over the other."

Section 7 of the Clayton Act. The court used an often-used conceptual "burden-shifting framework" to evaluate whether the effect of a merger "may be to substantially lessen competition or to tend to create a monopoly" under Section 7 of the Clayton

Act. In this case, the framework requires the FTC to first "establish a prima facie case that the merger is likely to substantially lessen competition in the relevant market." If that is established, in order for it to prevail, Illumina must "present evidence that the prima facie case inaccurately predicts the . . . transaction's probable effect on future competition" or "sufficiently discredit the evidence underlying the prima facie case." If Illumina is successful in rebutting the presumption, the FTC can still win if it produces "additional evidence of anticompetitive effects." The FTC bears the "ultimate burden of persuasion," and, the court observed, "in practice, evidence is often considered all at once and the burdens are often analyzed together."

Market Definition
The Fifth Circuit agreed with the FTC's definition of the relevant product market as being "the research, development, and commercialization of MCED tests." The court, like the FTC, found that "practical indicia" supported the finding of such a market, including that MCED tests have "peculiar characteristics and uses"; are designed for "distinct customers"; will likely have their own distinct pricing strategy; and that MCED developers, including Grail, see themselves as competing in a distinct market and view each other as key competitors.

The court rejected Illumina's argument that the market should be limited to only "products that currently exist" and have capabilities that are "identical" to Grail's, but not include "those that are anticipated or expected" and have only a subset of Grail's capabilities. Here, the court recognized that the "mere fact that some company, someday may innovate a competing product" would be "too speculative" to affect market definition. However, in this case there was "indisputably ongoing competition to bring additional products to market." The court also held that "products need not be identical to be in the same market" but need only to be "similar in character or use." The court also observed that even tests with lesser capabilities could "take sales away" from Grail "if they were priced lower." Notably, the court suggested that Illumina's proposed single-brand market was overly narrow, particularly because the market at issue here is a "research-and-development market." Moreover, as can sometimes be the case, the court found that a party's own documents undermined its argument. Here, Grail's documents reflected that it viewed itself as being in active competition with other MCED-test developers.

Effect on Competition
The Fifth Circuit acknowledged that "courts have used two different but overlapping standards for evaluating the likely effect of a vertical transaction." One is based on the Supreme Court's 1962 opinion in *Brown Shoe* v. *United States* (which is also the source of the "practical indicia" market definition standard). The other "asks whether the merged firm will have both the ability and the incentive to foreclose its rivals, either from sources of supply or from distribution outlets." Former FTC Commissioner Wilson, in her concurrence, wrote that "there is no '*Brown Shoe* standard' in modern antitrust analysis." In any event, regardless of the standard used, the majority of the FTC, former Commissioner Wilson and the Fifth Circuit all came to the same conclusion: that FTC complaint counsel established a prima facie case that the Illumina-Grail merger is likely to substantially lessen competition.

The court found that as the "monopoly supplier of a key input – NGS platforms – to MCED-test developers," Illumina had the ability to foreclose its MCED test rivals. And Illumina's ownership of Grail gave it the incentive to foreclose those rivals because the foreclosure would divert profitable sales from the rivals to Illumina-Grail. As to Illumina's claim that the threat of reputational damage would disincentivize foreclosure, the court wrote there are subtle ways to "engage in foreclosing behavior" that would not damage Illumina's reputation. Moreover, given Illumina's NGS monopoly, "even if other customers did learn about Illumina's foreclosing behavior and therefore wanted to take their business elsewhere, they would have nowhere else to turn."

The court also found that "at least four of the factors" from the *Brown Shoe* standard "supported a finding of a probable Section 7 violation." These were: "likely foreclosure, the nature and purpose of the transaction, the degree of market power possessed by the merged firm, and entry barriers."

The Parties' Post-Complaint "Fix"
To address the concern that it would engage in foreclosure, after the FTC initiated its enforcement action, Illumina announced an open, irrevocable offer for NGS supply. The parties and the commissioners had differing views on how to treat this Open Offer in the competitive analysis of the merger.

The court found that the Open Offer was "a post-signing, pre-closing adjustment to the status quo implemented by the merging parties to stave off concerns about potential anticompetitive conduct." The court described this as "somewhere in between a fact and a remedy." Given the nature of the Open Offer, the court held that "the burden of showing [its] competitive effects [is] on Illumina as part of its rebuttal to the prima facie case" in the liability stage of the case. To meet this burden, "Illumina was required to do more than simply put forward the terms of the Open Offer; it needed to affirmatively show why the Open Offer undermined Complaint Counsel's prima facie showing to such an extent that there was no longer a probability that the Illumina-Grail merger would substantially lessen competition." Put another way, to rebut the prima facie case, "Illumina was only required to show that the Open Offer sufficiently mitigated the merger's effect such that it was no longer likely to substantially lessen competition. Illumina was not required to show that the Open Offer would negate the anticompetitive effects of the merger entirely."

By contrast, the Fifth Circuit found that the FTC committed legal error when it used a "total-negation" standard that required Illumina "to show that the Open Offer would restore the pre-[merger] level of competition, i.e., eliminate Illumina's ability to favor Grail and harm Grail's rivals." This meant that "[i]n effect, Illumina could only rebut Complaint Counsel's showing of a likelihood of a substantial reduction in competition with a showing that, due to the Open Offer, the merger would not lessen competition at all."

In placing the proper analysis of the Open Offer in Illumina's rebuttal stage, the court reasoned that "the Open Offer is not just a normal commercial supply agreement but instead a direct response to anticompetitive concerns over the Illumina-Grail merger" and should therefore not be treated "as just another fact of the marketplace" to be dealt with at the prima facie stage where FTC complaint counsel has the burden to establish that harm to competition is likely. Nor, according to the court, is the Open Offer "a Commission- or court-ordered remedy, which . . . can be imposed only on the basis of a violation of the law, i.e., after a finding of liability." Treating the Open Offer as a remedy to be evaluated only after a finding of liability would have required Illumina to prove that the Open Offer would "preserve exactly the same level of competition that existed before the merger."

Efficiencies
Finally, the court found that none of the efficiencies put forward by Illumina were "cognizable" because they were not merger specific, verifiable or "likely to be passed through, at least in part, to consumers." Among other rejected efficiencies, the court found that while a royalty reduction was merger specific because evidence suggested that Grail would be unable to achieve a similar reduction from Illumina absent the merger, Illumina had not shown that the reduction would be passed through to its customers. Further, the court also found that Illumina failed to quantify any benefit from the elimination of double marginalization resulting from Grail no longer having to pay Illumina for NGS. Illumina also failed to substantiate claims of "supply chain and operational efficiencies," accelerated FDA approval, R&D efficiencies or accelerated international expansion of Galleri.

Significance
Vertical merger theory of harm. Litigated vertical merger cases are rare, and appeals court cases dealing with vertical merger cases are even rarer. The last appeals court opinion in a vertical merger case, in which the D.C. Circuit decided the government's appeal to its unsuccessful challenge of the A&T-Time Warner merger, was issued in 2019. Before that, it had been decades since the government challenged a vertical deal in court. Therefore, an appeals court opinion in a vertical merger case is noteworthy. Here, the fact that the Fifth Circuit endorsed a vertical theory of competitive harm is especially significant given the dearth of appellate case law in this area. Left unresolved, however, is what specific standard is to be used in evaluating the likely competitive effects of a vertical merger. In general, *Brown Shoe* was more skeptical of vertical mergers than most current economic theory, but, as the court observed, the outcome in this case did not depend on which standard was used.

Standard for evaluating post-complaint deal fixes. It is also significant that the Fifth Circuit articulated a standard for evaluating a deal fix in the circumstances presented in this case that is more favorable to merging parties than the standard the FTC favored. This could be especially consequential in the current merger enforcement environment where the agencies – in particular the DOJ – are much less willing to agree to a negotiated merger remedy, thus requiring the merging parties to "litigate the fix" in court. Indeed, this has been an issue in several recent merger cases, including the FTC's challenge of Microsoft-Activision and the DOJ's challenge to UnitedHealth-Change Healthcare.

R&D market definition. The court made several observations about the task of defining an R&D market like the one at issue in this case. *First*, according to the court, because the products at issue are in development and have not yet been sold for a price, certain common market definition tools – such as performing the hypothetical monopolist test or calculating the cross-elasticity of demand – cannot be used because they depend on price. *Second*, the court wrote that defining an R&D market requires making assumptions about the effectiveness of "anticipated or expected" products, not simply observing the qualities of "products that currently exist." *Third*, the court reasoned that given the nature of R&D markets, it may be acceptable to define a market around a group of products even though the products are different in certain ways. Here, Illumina advocated for a single-brand market containing only its tests because other MCED tests were different from Grail's. The court wrote that "[a]ntitrust law does not countenance such a cramped view of competition, particularly in a research-and-development market."

Constitutionality. The Fifth Circuit's holding that Illumina's nondelegation, executive power, equal protection and due process claims were each "foreclosed by Supreme Court authority" is significant. After recent Supreme Court decisions regarding administrative power, parties to several other FTC actions have also been raising constitutional issues. The fact that the Fifth Circuit – a court that has recently found constitutional infirmities with administrative enforcement in other contexts – sided with the FTC is notable. Given Illumina's decision to not appeal, this case will likely not be a vehicle for the Supreme Court to revisit these issues.

For the full text of our memorandum, please see:

- https://www.paulweiss.com/media/3984138/fifth_circuit_accepts_vertical_harm_theory_and_establishes_standard_for_evaluating_merger_fixes.pdf

For the Fifth Circuit's opinion in *Illumina*, please see:

- https://www.ca5.uscourts.gov/opinions/pub/23/23-60167-CV0.pdf

9. Delaware Court of Chancery Questions Enforceability of *Con Ed* Provisions

In *Crispo* v. *Musk* ("*Crispo*"), the Delaware Court of Chancery, in an opinion by Chancellor McCormick, addressed the enforceability of merger agreement provisions related to the recovery of lost-premium damages by the target. Such "*Con Ed* provisions"—named after the Second Circuit's opinion in *Consolidated Edison, Inc.* v. *Northeast Utilities*—attempt to clarify that damages for lost merger premiums are recoverable from a wrongfully terminating buyer by the target or stockholders in certain circumstances. *Crispo* suggests that while Delaware courts will likely not permit the target to recover lost-premium damages for itself or on behalf of stockholders, target stockholders themselves would have that right in certain circumstances.

Background

In *Con Ed*, the Second Circuit applied a no-third-party-beneficiaries provision to hold that under New York law, stockholders could not enforce a merger agreement against a buyer who wrongfully terminated and seek damages for the lost merger premium. The holding threatened to shift the balance of negotiating leverage in mergers, allowing buyers to walk away with little consequence other than the payment of certain fees and expenses.

In response, parties began adopting provisions addressing the recovery of lost premiums. One variation of these so-called "*Con Ed* provisions" expressly provides stockholders with third-party-beneficiary status, but, as recognized by the *Crispo* court, this could lead to a proliferation of lawsuits and undermine the target's ability to control the litigation asset and achieve a favorable outcome for all stockholders. Another variation makes the target an agent for recovering damages on behalf of its stockholders, but again, as noted by the *Crispo* court, there is "no legal basis" for a contracting party unilaterally to appoint itself as an agent to control a non-party's rights. A third variation, which was at issue in *Crispo*, defines damages resulting from the wrongful breach to include lost premiums in an attempt to allow the target itself to recover the premiums.

Crispo

Crispo involved Elon Musk and his affiliated entities' acquisition of Twitter, Inc. After Musk purported to terminate the transaction, plaintiff brought claims alleging that buyers had breached the merger agreement. The buyers eventually had a change of heart and closed the transaction, and the plaintiff sought mootness fees for his claim's role in the merger's consummation.

In determining whether the plaintiff's breach claim was meritorious when filed—a key element of a mootness fee petition—the court discussed the enforceability of *Con Ed* provisions. According to the court, *Con Ed* provisions are unenforceable under Delaware law if they define lost-premium damages to be exclusive to the target. Recovery by the target would be an unlawful contractual penalty because merger consideration, including premiums, is paid directly to the stockholders, so the target itself has no expectation or right to lost-premium damages.

The court then interpreted the merger agreement's lost-premium damages definition and a seemingly contradictory no-third-party-beneficiaries provision to confer to the stockholders third-party-beneficiary status to seek lost-premium damages, but not while the company pursues a claim for specific performance. Another interpretation was that the stockholders did not have third-party-beneficiary status in any case, but that would render the lost-premium damages provision unenforceable and violate a cardinal rule of contract construction that all contract provisions should be given effect. Under either interpretation, however, the plaintiff lacked standing to sue for lost-premium damages when he filed suit, and therefore, his mootness fee was denied.

Takeaways

Though the *Crispo* opinion is not a direct holding on the *Con Ed* and third-party-beneficiary provisions, it reflects the court's views on the merits of such provisions and that it will engage in detailed scrutiny of the parties' intent behind such provisions. It does alleviate practitioners' concerns that *Con Ed*, if followed in Delaware, would foreclose upon any party's ability to recover lost-premium damages, and confirms that with proper drafting, Delaware courts will permit stockholders themselves to recover such damages against a wrongfully terminating buyer under the merger agreement, at least where specific performance is not an available remedy.

For the full text of our memorandum, please see:

- https://www.paulweiss.com/media/3983974/delaware_court_of_chancery_questions_enforceability_of_con_ed_provisions.pdf

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

- https://courts.delaware.gov/Opinions/Download.aspx?id=354960

10. Federal Court Denies Defendant's Summary Judgment Motion in SEC "Shadow Trading" Case

Introduction

On November 20, 2023, the District Court for the Northern District of California denied Defendant Matthew Panuwat's motion for summary judgment on the SEC's claim that he violated the federal securities laws by improperly engaging in "shadow trading"—i.e., trading in securities of a similarly situated competitor's shares while in possession of insider information about his

own company. The court identified a broad range of evidence that could be considered in determining the materiality of information about one company to securities issued by another.

Background

The SEC claims that in April 2016, Defendant Matthew Panuwat, a then-senior director of business development of midcap biopharmaceutical firm Medivation, purchased call options for the stock of Incyte, a Medivation competitor, minutes after learning of a pending but then-unannounced Medivation merger with yet another company. When the merger was announced publicly several days later, the stock price of Medivation, Incyte and other mid-cap biopharmaceutical companies significantly increased. Based on his purchases of Incyte shares, Panuwat allegedly realized over $100,000 in profits. The SEC sued Panuwat, alleging he had engaged in insider trading in violation of Section 10(b) of the Exchange Act and SEC Rule 10b-5. On January 14, 2022, Judge Orrick denied Panuwat's motion to dismiss for failure to state a claim. On September 27, 2023, following discovery, Panuwat moved for summary judgment on the SEC's claim.

The District Court for the Northern District of California Denies Panuwat's Summary Judgment Motion

In his summary judgment motion, Panuwat argued that Medivation and Incyte were "fundamentally different companies" without an economic or business connection, that Medivation's policies did not prohibit him from investing in Incyte and that his Incyte trading was consistent with his trading history. In particular, Panuwat argued the SEC could not demonstrate that the information concerning Medivation's acquisition "was both nonpublic and material to Incyte, a biopharmaceutical company that had no relationship or business dealings with Mr. Panuwat's employer, Medivation, and no connection to the Medivation sale process."

In denying Panuwat's summary judgment motion, the court held that the SEC had shown genuine disputes of material fact concerning (i) whether Panuwat received nonpublic information, (ii) whether that information was material to Incyte, (iii) whether Panuwat breached his duty to Medivation by using its confidential information to benefit himself and (iv) whether Panuwat acted with scienter.

First, the court held there was a genuine dispute of material fact as to whether there was a sufficient connection between Medivation such that a jury could find the Medivation merger information was material to Incyte. In so holding, the court pointed to evidence that Medivation and Incyte had a sufficient "market connection." That evidence included analyst reports and financial news articles repeatedly linking Medivation's acquisition to Incyte's future. The court also pointed to evidence suggesting that Medivation's investment bankers considered Incyte to be a "comparable peer" to Medivation and the increase in Incyte's stock price following the Medivation merger announcement as further evidence of a sufficient connection between the two companies.

Second, the court held there was sufficient evidence to support a finding that Panuwat breached the duty of trust and confidence he owed Medivation. In particular, the court pointed to Medivation's insider trading policy (which, among other things, prohibited trading in a non-exhaustive list of other public companies' securities), its confidentiality agreement and Medivation's entrustment to Panuwat of confidential information.

Finally, the court held there was a genuine dispute of material fact as to Panuwat's scienter, relying on, among other things, the proximity in time between his receipt of the email with the merger information and his initiation of his Incyte trades.

Implications

This case marks what appears to be the first time the SEC has brought a lawsuit alleging that information about one firm could be considered material to investors of another firm because of the two firms' similarities or connections. In its summary judgment opinion, the court took a broad view of the evidence relevant to the question of materiality in this type of case. Notably, even though the court acknowledged that Medivation and Incyte had drugs approved for "different diseases and patients" and did not "share approved drug products or develop the same drugs," it nevertheless concluded there was a material factual dispute about whether the companies were related based on analyst reports and financial news articles linking

the events at the two relevant companies, the correlation between the stock performance of the two companies and witness accounts of the connections between the two companies.

The court's opinion, and in particular its guidance on when information about one company may be material to investors in another, may further embolden the SEC to more aggressively pursue insider trading enforcement actions where these types of evidence could suggest that the companies are viewed by the market as more directly comparable or sufficiently correlated.

Moreover, the court's summary judgment opinion further highlights the significance of the specific terms of a company's insider trading policy to the question of whether an employee has breached a relevant duty by engaging in shadow trading. Companies may wish to review the scope of their insider trading policy and ensure that those subject to the policy are aware of the scope.

For the full text of our memorandum, please see:

- https://www.paulweiss.com/media/3984048/federal_court_denies_defendants_summary_judgment_motion_in_sec_shadow_trading_case.pdf

11 Congress Passes Foreign Extortion Prevention Act, Expanding Federal Criminal Liability to Foreign Officials

On December 14, 2023, Congress passed the Foreign Extortion Prevention Act ("FEPA") with bipartisan support as part of the National Defense Authorization Act for Fiscal Year 2024. President Biden is expected to sign the law. FEPA will establish criminal liability for foreign officials who "corruptly demand, seek, receive, accept, or agree to receive or accept, directly or indirectly, anything of value" from (a) any person while in the territory of the United States, (b) a U.S. issuer or (c) a domestic concern, in exchange for an improper business advantage. With FEPA enacted as a complement to the U.S. Foreign Corrupt Practices Act ("FCPA"), the U.S. will join a host of strategic allies in a growing multilateral effort to criminalize demand-side foreign bribery as well as supply-side.

Key Takeaways

- All companies whose business interacts with foreign government officials should review their anti-corruption compliance programs and consider revisions where necessary to address what is likely to be a new area of DOJ enforcement. Among the areas that may require particular attention are:
  - Considering the extent to which anti-corruption, third-party due diligence, gifts, travel and entertainment, and other related policies need to be revised in light of FEPA's expanded definition of who is a "foreign official";
  - Updated training for personnel who interact with any person who is a "foreign official" under FEPA; and
  - Heightened scrutiny and due diligence regarding third parties and third-party transactions involving current and former foreign officials, their family members and associates.
- The passage of FEPA reflects the Biden Administration's and the DOJ's emphasis on addressing corporate crime through the lens of national security concerns, empowering the DOJ to focus in particular on foreign officials in countries that the U.S. government perceives to pose national security threats.
- The extent to which FEPA significantly increases the DOJ's anticorruption efforts remains to be seen, including because aggressive FEPA prosecutions could lead to diplomatic conflicts with the nations whose foreign officials are subject to prosecution.
- The interplay between FEPA enforcement and FCPA enforcement will require close attention as the DOJ articulates its expectations of companies that voluntarily self-disclose and/or cooperate with respect to the implicated "foreign officials."

Background

The FCPA's anti-bribery provisions criminalize the payment of anything of value to a foreign government official for certain business-related benefits. FEPA will serve as the long-awaited companion to the FCPA by extending criminal liability to foreign government officials who demand or receive improper payments from U.S. persons or while in U.S. territory. Receipt of those payments is not currently covered by the FCPA.

Although FEPA amends the federal domestic bribery statute, 18 U.S.C. § 201, it borrows heavily from the FCPA. FEPA's definition of "foreign official" is, however, broader than that of the FCPA because it encompasses not only those individuals acting in an official governmental capacity, but also those acting in an unofficial capacity. In addition, FEPA expands the definition to include "any senior foreign political figure," which encompasses certain current or former senior foreign officials (whether elected or not), politicians, executives of government-owned commercial enterprises and their family members, close associates and businesses.

FEPA also incorporates a similar jurisdictional framework to the FCPA by encompassing offenses that occur in or with a sufficient nexus to the United States, including where the conduct occurs within a U.S. territory, the demand is of a company that issues U.S. securities or the demand is directed at a U.S. "domestic concern," including U.S. citizens, nationals and business entities.

The DOJ has previously leveraged U.S. anti-money laundering laws to prosecute foreign government officials involved in bribery schemes, so FEPA is likely to make the DOJ even more active in this space. If the bill is signed into law, in the months ahead, the DOJ will likely announce and begin to implement an enforcement program. We also expect the DOJ to provide guidance about which part of the DOJ's Criminal Division will have primary enforcement authority for FEPA and the extent to which companies seeking FCPA resolutions may also be required to cooperate with FEPA prosecutions. FEPA prosecutions may also raise legal issues for U.S. courts to resolve, including with respect to prosecutions of foreign officials who seek bribes from entities they do not know are U.S. issuers or domestic concerns. FEPA also requires DOJ to submit an annual report to Congress noting activity under the statute and enforcement efficacy. Penalties under FEPA include imprisonment of up to 15 years and fines up to the greater of $250,000 or three times the value of the bribe.

Notably, Members of Congress have explicitly linked FEPA to concerns related to national security and ongoing concerns with leveling the playing field for U.S. companies. Applauding the Senate's passage of FEPA, Senator Sheldon Whitehouse (D-RI) said: "America is in a clash of civilizations with international kleptocrats and criminals seizing any and every opportunity to extort American businesses and undermine our national security." Senator Thom Tillis (R-NC) added that "American businesses too often face bribery demands from foreign officials, putting them at an economic disadvantage for following the law."
For the full text of our memorandum, please see:

- https://www.paulweiss.com/media/3984137/congress_passes_foreign_extortion_prevention_act_expanding_federal_criminal_liability_to_foreign_officials.pdf

For the full text of FEPA, please see:

- https://www.congress.gov/bill/117th-congress/house-bill/4737/text?s=1&r=8

2023 Developments (First through Third Quarters)

1. SEC Adopts New Cybersecurity Disclosure Requirements

The SEC has adopted new disclosure requirements to enhance and standardize public company disclosures regarding cybersecurity risk management and incident reporting. Domestic issuers are required to disclose material cybersecurity incidents within four business days on Form 8-K, and to provide annual disclosure regarding their cybersecurity governance and risk management. Foreign private issuers ("FPIs") are required to make corresponding disclosures regarding cybersecurity governance and risk management on Form 20-F and to disclose material cybersecurity incidents on Form 6-K that they must disclose or publicize in a foreign jurisdiction, to any stock exchange, or to security holders. The SEC did not make any

amendments to Form 40-F disclosure requirements. The final rules reflect the SEC's response to comments calling for more measured disclosure requirements, including, among other things, the elimination of the proposed requirement to disclose whether a board has cybersecurity expertise, the addition of a procedure to delay disclosure if the U.S. Attorney General determines that the disclosure would pose a substantial risk to national security or public safety and more explicit language that the disclosure be focused on material cybersecurity risks and impacts.

New Item 1.05 of Form 8-K, and the corresponding amendment to Form 6-K, require current disclosure of material "cybersecurity incidents," which the SEC has defined as "an unauthorized occurrence, or a series of related unauthorized occurrences, on or conducted through a company's information systems that jeopardizes the confidentiality, integrity, or availability of a company's information systems or any information residing therein." The determination of whether a cybersecurity incident is material remains unchanged and is determined by the same principles articulated repeatedly by the courts and the SEC—namely, whether there is a substantial likelihood that a reasonable investor would consider it important. Disclosures of material cybersecurity incidents pursuant to new Item 1.05 of Form 8-K should include material aspects of the nature, scope and timing of the incident, and the material impacts or reasonably likely material impacts on the company, including its financial condition and results of operations. If any of these details are unavailable at the time of filing an initial Form 8-K, such information must be disclosed within four business days of its becoming available via an amendment filed on Form 8-K/A. In their disclosures, companies are not required or expected to publicly disclose specific, technical information about their planned responses to the incident or their cybersecurity systems, related networks and devices or potential system vulnerabilities, at a level of detail that could hamper their ability to respond to or remedy the incident. FPIs are required to include on Form 6-K disclosure of material cybersecurity incidents that they must disclose or publicize in a foreign jurisdiction, to any stock exchange or to security holders.

New Item 106 of Regulation S-K and new item 16K of Form 20-F require companies to include in Annual Reports on Form 10-K and 20-F, respectively, a discussion about their cybersecurity risk management, strategy and governance covering the following topics:

- **Cybersecurity risk management**: Companies must describe their processes for assessing, identifying and managing material risks from "cybersecurity threats," defined as any "potential unauthorized occurrence on or conducted through a company's information systems that may result in adverse effects on the confidentiality, integrity, or availability of a company's information systems or any information residing therein." In the disclosure, companies must address a number of non-exclusive factors, including whether and how any such processes have been integrated into the company's overall risk management system or processes, whether the company engages third parties in connection with such processes, and whether the company has processes to oversee and identify any such cybersecurity threats associated with its use of any third-party service providers. The disclosure must also describe whether any risks from cybersecurity threats (including prior incidents) have materially affected or are reasonably likely to materially affect the company, including its business strategy, results of operations or financial condition, and if so, how.

- **Board oversight of cybersecurity risks**: Companies must describe the board's oversight of risks from cybersecurity threats, including an identification of any board committee(s) responsible for such oversight, and a description of the process by which the board or any committee is informed about cybersecurity risks.

- **Management oversight of cybersecurity risks**: Companies must also describe the role of management in assessing and managing material risks from cybersecurity threats. In particular, companies must address a number of non-exclusive factors, including which management positions or committees are responsible for assessing and managing cybersecurity risks and the relevant expertise of such persons, the process by which such persons or committees are informed about and monitor the prevention, detection, mitigation and remediation of cybersecurity incidents, and whether such persons or committees report information about such risks to the board or its committees.

These new disclosure requirements do not apply to Canadian MJDS filers who file annual reports on Form 40-F.

Companies were required to comply with the Form 8-K and Form 6-K disclosure requirements starting on December 18, 2023, except for smaller reporting companies, which have until June 15, 2024. All companies must provide the cybersecurity governance and risk management disclosure in annual reports filed for fiscal years ending on or after December 15, 2023 (i.e., calendar-year-end companies will be required to include this in next year's Annual Report on Form 10-K or 20-F).
For the full text of our memorandum, please see:

- https://www.paulweiss.com/media/3983604/sec_adopts_new_cybersecurity_disclosure_requirements.pdf

For the SEC's final rules, please see:

- https://www.sec.gov/files/rules/final/2023/33-11216.pdf

2. SEC Approves Clawback Listing Standards

On June 9, 2023, the SEC approved the clawback listing standards of the New York Stock Exchange and Nasdaq. The clawback listing standards took effect on October 2, 2023, and listed companies had until December 1, 2023 to adopt compliant policies.

NYSE-listed companies that have failed to adopt a clawback policy within 60 days of the effective date of the standards (i.e., by December 1, 2023) must issue a press release identifying their delinquency, the reasons for it, and, if known, the date by which they expect to be in compliance. Nasdaq-listed companies that have failed to adopt a clawback policy within 60 days of the effective date of the standards (i.e., by December 1, 2023) are eligible to submit a plan of compliance to Nasdaq staff within 45 days and will have access to cure rights, in accordance with existing Nasdaq procedures. Under both NYSE and Nasdaq clawback listing standards, listed companies will only be required to claw back incentive awards received (as therein defined) on or after the October 2, 2023 effective date.

For the full text of our memorandum, please see:

- https://www.paulweiss.com/media/3983474/sec_approves_clawback_listing_standards_listed_companies_have_until_december_1_2023_to_adopt_compliant_policies.pdf

For the full text of our memorandum regarding the SEC's adoption of the clawback requirements, please see:

- https://www.paulweiss.com/media/3982698/sec_adopts_final_clawback_rules.pdf

For the SEC's final rules, please see:

- https://www.sec.gov/files/rules/final/2022/33-11126.pdf

3. SEC Adopts Rules to Shorten the Securities Settlement Cycle

The SEC has adopted amendments to Rule 15c6-1 under the Exchange Act to shorten the securities settlement cycle for most transactions to T+1 (from T+2), and for firm commitment offerings priced after 4:30 p.m. (New York City time) to T+2 (from T+4). The SEC has also amended Rule 15c6-1(b) to exempt security-based swaps from the Rule 15c6-1 settlement deadlines (contracts involving the purchase or sale of unlisted/unquoted limited partnership interests will continue to be exempt from these settlement deadlines as well).

In order to facilitate the shortened settlement cycle, the SEC has adopted additional new rules that will require brokers and dealers to enter into agreements, or to establish, maintain and enforce policies and procedures, providing for the completion of allocations, confirmations, affirmations or any combination thereof, on a same day basis, and for investment advisers to make and keep records of confirmations received and allocations and affirmations sent. The SEC has also adopted new rules which will

require central matching service providers to adopt policies and procedures to facilitate straight-through processing (and to file annual reports regarding their progress with respect to straight-through processing).

These amendments and new rules, including the amendments exempting security-based swaps from Rule 15c6-1, became effective on May 5, 2023. Otherwise, compliance will be required as of May 28, 2024.

For the full text of our memorandum, please see:

- https://www.paulweiss.com/media/3983098/sec_adopts_rules_to_shorten_the_securities_settlement_cycle.pdf

For the SEC final rules, please see:

- https://www.sec.gov/files/rules/final/2023/34-96930.pdf

4. FTC and DOJ Release Proposed Rulemaking to Update the HSR Form; Proposals Significantly Increase Required Disclosures

On June 27, 2023, the FTC, in coordination with the DOJ's Antitrust Division (together, the "Agencies"), issued a Notice of Proposed Rulemaking (the "NPRM") to amend the Hart-Scott-Rodino Antitrust Improvements Act of 1976 (the "HSR Act") Form and Instructions to require additional information in initial and refiled submissions.

The NPRM proposes numerous additional requirements, including extensive information disclosures relating to areas traditionally governed by other federal agencies such as labor, defense, international trade and national security and would prove extremely burdensome and time-consuming for filers, although the Agencies expressed some willingness to balance parties' burdens with information helpful to the Agencies' review process in implementing amendments to the HSR Form. Some of the most significant changes to the HSR Form contemplated under the NPRM include:

- disclosing "subsidies" received from a "foreign entity of concern," including governments and agencies of foreign countries that are covered under 42 U.S.C. 18741(a)(5)(C) (e.g., foreign terrorist organizations, Office of Foreign Assets Control-designated nationals or blocked persons, persons or entities which have been convicted under espionage-related Acts);

- requiring filers to report certain contracts with defense or intelligence agencies;

- providing draft transaction agreements or term sheets that "provide sufficient detail about the scope of the entire transaction" if filing before there is a definitive executed agreement;

- requiring a written narrative describing horizontal and vertical overlaps and other competitive dynamics in transactions;

- expanding the scope of custodians subject to "Item 4" document disclosure to include supervisory deal team lead(s) that are not officers or directors;

- requiring drafts of responsive "Item 4" documents to be submitted if those drafts were provided to an officer, director or supervisory deal team lead;

- requiring submissions of ordinary course strategic plan documents;

- providing verbatim English-language translations for all foreign-language documents;

- eliminating North American Product Classification System revenue data allocation and instead implementing new data collection methods which include commuter zone and occupational classification data regarding the filing person's employees;

- requiring identification of any penalties or findings issued against the filer by the Department of Labor, National Labor Relations Board or OSHA during the previous five years;

- requiring the reporting of North American Industry Classification System codes for certain pipeline or pre-revenue products and expanding overlap disclosures to include pre-revenue and pipeline products anticipated to have annual revenue totaling more than $1 million within the following two years;

- expanding the description of the ultimate parent entity ("UPE") and requiring, for each entity within the UPE, the identification of all current officers, directors (to facilitate the agencies' assessment of Section 8 interlocking directorate issues), board observers or those who served in the past two years, and "other type of interest holders that may exert influence," which could include certain creditors and option/warrant holders;

- expanding disclosure of prior acquisitions from the past five years to the past ten years, and eliminating any assets or revenue thresholds which may have limited prior disclosures (under the proposed rules, acquisitions of new entrants, nascent competitors or a pattern of small roll-ups would now be identified);

- expanding disclosures of 5%+ minority holders; notably identifying (i) limited partners in partnerships rather than just the general partner as is currently required, and (ii) minority holders of any entities within the control chain of other acquiring entity rather than just the acquiring entity and its UPE; and

- requiring transaction diagrams and organization structure charts.

The NPRM also contemplates requiring additional information regarding the terms of the transaction, investors and employees, additional transaction and strategic documents, as well as certain ordinary-course business documents that discuss competition in the markets that may be affected by the transaction, information about other reviewing jurisdictions, including a voluntary waiver option to permit cross-jurisdictional sharing of information submitted in the HSR process, and identification of any communication or messaging systems on any device used by the filer.

On June 29, 2023, the proposed changes were published in the Federal Register and the Agencies accepted public comments until August 28, 2023. As of the date of this memorandum, the Agencies have not implemented the proposed rules.

For the full text of our memorandum, please see:

- https://www.paulweiss.com/media/3983513/ftc_and_doj_release_proposed_rulemaking_to_update_the_hsr_form_proposals_significantly_increase_required_disclosures.pdf

For the proposed changes to the HSR Form, please see:

- https://www.govinfo.gov/content/pkg/FR-2023-06-29/pdf/2023-13511.pdf

5. FTC Announces Hart-Scott-Rodino and Clayton Act Section 8 Thresholds for 2023

The FTC has revised the jurisdictional and filing fee thresholds of the HSR Act and the Premerger Notification Rules (the "Rules"), based on changes in the gross national product ("GNP") as required by the 2000 amendments to the HSR Act. The filing thresholds increased as a result of the increase in the GNP and apply to transactions that closed on or after February 27, 2023, and the new filing fees apply to HSR filings submitted on or after February 27, 2023.

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

i. Size of Transaction

The minimum size of transaction threshold, which is effective as of February 27, 2023, is $111.4 million, increased from the 2022 threshold of $101 million.

ii. Size of Parties

The size of parties threshold is inapplicable if the value of the transaction exceeds $445.5 million ($403.9 million in 2021). For transactions with a value between $111.4 million and $445.5 million, the size of parties threshold must be met and will be satisfied in one of the following three ways:

	I	II	III
Acquiring Person:	$222.7 million annual net sales or total assets	$222.7 million annual net sales or total assets	$22.3 million annual net sales or total assets
	and	and	and
Acquired Person:	$22.3 million total assets	a manufacturer with $22.3 million annual net sales or total assets	$222.7 million annual net sales or total assets

The various jurisdictional thresholds, notification thresholds, filing fee thresholds and thresholds applicable to certain exemptions were also increased.

iii. Filing Fees

On December 29, 2022, the President signed into law H.R. 2617, the Consolidated Appropriations Act, 2023, which included the Merger Filing Fee Modernization Act. This Act required the FTC to revise the filing fee thresholds annually. In 2022, HSR filing fees were $45,000 for transactions valued in excess of $101 million but less than $202 million; $125,000 for transactions valued at $202 million or more but less than $1.0098 billion; and $280,000 for transactions valued at $1.0098 billion or more. For all filings made on or after February 27, 2023, the new HSR filing fees are as follows:

Filing Fee	Size of Transaction
$30,000	More than $111.4 million, but less than $161.5 million
$100,000	$161.5 million or more, but less than $500 million
$250,000	$500 million or more, but less than $1 billion
$400,000	$1 billion or more, but less than $2 billion
$800,000	$2 billion or more, but less than $5 billion

$2,250,000	$5 billion or more

The above fees will adjust annually in line with any change in the Consumer Price Index.

The FTC also announced the maximum civil penalty for HSR Act violations, raising the amount from $46,517 per day to $50,120 per day, effective as of January 11, 2023.

Finally, the FTC has increased, effective on January 20, 2023, the thresholds that prohibit, with certain exceptions, competitor companies from having interlocking relationships among their directors or officers under Section 8 of the Clayton Act. Section 8 provides that no person shall, at the same time, serve as a director or officer in any two corporations (not other business structures (e.g., partnerships or LLCs)) that are competitors, such that elimination of competition by agreement between them would constitute a violation of the antitrust laws. There are several "safe harbors" which render the prohibition inapplicable under certain circumstances, such as when the size of the corporations, or the size and degree of competitive sales between them, are below certain dollar thresholds. Competitor corporations are now subject to Section 8 if each one has capital, surplus and undivided profits aggregating more than $45,257,000, although no corporation is covered if the competitive sales of either corporation are less than $4,525,700. Even when the dollar thresholds are exceeded, other exceptions preventing the applicability of Section 8 may be available. In particular, if the competitive sales of either corporation are less than 2% of that corporation's total sales, or less than 4% of each corporation's total sales, the interlock is exempt. In addition, Section 8 provides a one-year grace period for an individual to resolve an interlock issue that arises as a result of an intervening event, such as a change in the capital, surplus and undivided profits or entry into new markets.

For the full text of our memorandum, please see:

- https://www.paulweiss.com/media/3982984/ftc_announces_new_hart_scott_rodino_and_clayton_act_section_8_thresholds_for_2023.pdf

For the FTC text of 2023 thresholds, please see:

- https://www.govinfo.gov/content/pkg/FR-2023-01-26/pdf/2023-01533.pdf

6. Delaware Case Law Developments

Delaware Court of Chancery Will Require Supplemental Disclosures to Be "Plainly Material" to Justify Mootness Fee Awards

In *Anderson* v. *Magellan Health, Inc.* ("*Magellan*"), the Delaware Court of Chancery drastically reduced a plaintiff's mootness fee request and held, in an opinion by Chancellor McCormick, that, moving forward, plaintiffs can justify a mootness fee only if they obtain supplemental disclosures that are "plainly material." In so holding, the court split with prior Court of Chancery precedent requiring that such disclosures be merely "helpful" to support a mootness fee. The result is that the standard required for supplemental disclosures in the context of a mootness fee award is now higher and in line with the "plainly material" standard established for disclosure-only settlements in *re Trulia, Inc. Stockholders Litigation*. *Magellan* also provides helpful guidance around the dollar value of mootness fee awards based on supplemental disclosures. The plaintiff also sought a mootness fee award based on the loosening of deal protections (specifically, the waiver of "don't-ask-don't-waive" standstill provisions), and while the court acknowledged that such waivers could result in a compensable corporate benefit by increasing the likelihood of a topping bid, the waivers here achieved "little-to-no value," and therefore did not justify a fee award.

Delaware Court of Chancery Upholds High/Low Vote Structure Based on Stockholder Identity

In *Colon* v. *Bumble, Inc.* ("*Colon*"), the Court of Chancery held that a provision in the charter of a Delaware corporation granting the company's founder and financial sponsor high voting power within the same class of stock also issued to the public shareholders was valid under the Delaware General Corporation Law (the "DGCL"). The provision, which, in simplified terms, provided that a share carried ten votes if held by the founder or sponsor (or anyone else party to a particular stockholder agreement), but only one vote if held by others, was consistent with long-standing Delaware precedent enforcing charter

provisions providing for formula-based allocations of voting power. Because the DGCL permits voting rights to be made dependent upon "facts ascertainable" outside of the charter, such "identity-based voting" is permissible under Delaware law. This decision validates a structure that may be of particular interest to those companies seeking to go public with a high/low vote structure, as it allows the maintenance of voting control with only one class of registered, liquid shares, without the need for an illiquid second class of stock.

Delaware Supreme Court Holds That Charter Provision Could Not Be Applied to Exculpate for Duty of Loyalty Breaches

In *CCSB Fin. Corp.* v. *Totta* ("*Totta*"), the Delaware Supreme Court, in an opinion by Chief Justice Seitz, affirmed the Court of Chancery's invalidation of a charter provision purporting to make good-faith board decisions regarding a stockholder voting limitation "conclusive and binding upon the Corporation and its stockholders." The voting limitation capped at 10% the stock that could be voted by a "person" (including stockholders acting in concert therewith) in any stockholder vote, as determined by the board. The Supreme Court held that the Court of Chancery must first test the board's decision under the provision itself, and then apply enhanced judicial review under established standards. Here, the company argued that the charter provision "eliminat[ed] the first step, and requires business judgment rule for the second step." While the court acknowledged that such a provision could be included in the organizational documents for a Delaware limited liability company or limited partnership, it could not be included for a corporation because the provision was an attempt to exculpate directors from a breach of the duty of loyalty, which is inconsistent with Section 102(b)(7) of the DGCL and Delaware public policy. Moreover, the court concluded that there was no equitable basis for the board's decision to direct the election inspector not to count votes in favor of an insurgent slate under the voting limitation, affirming the Court of Chancery's findings in this regard.

Delaware Court of Chancery Declines to Enforce Non-Compete in Employment Agreement

In *Centurion Service Group, LLC* v. *Wilensky* ("*Wilensky*"), the Delaware Court of Chancery held that a non-compete provision in an employment agreement was unenforceable. The court first addressed the parties' Delaware choice of law provision, which the court noted was "not necessarily binding." While Illinois had a materially greater interest in the issue than Delaware given that the company is an Illinois limited liability company with its principal place of business in Illinois, the former employee is an Illinois resident and the alleged breach occurred in Illinois, Delaware and Illinois law were largely in step on the enforceability of restrictive covenants, and therefore the court saw no basis to disturb the Delaware choice of law. The court then addressed the terms of the two-year non-compete. The court found the provision's restricted area, which included any area within the United States or abroad where the company is currently actively soliciting or engaging in its business (or actively planning to solicit or engage in) its business, to be overly broad. The court has now declined to enforce or blue-pencil non-compete provisions in three key contexts, including the sale-of-business (*Kodiak Building Partners, LLC* v. *Adams*), forfeiture-for-competition/partnership (*Ainslie* v. *Cantor Fitzgerald, L.P.*) and now employment (*Centurion*).

Delaware Court of Chancery Denies Dismissal of Claims Against Officers of LLC for Failing to Make Disclosures Despite Competing Duty of Obedience to the Board

In *Cygnus Opportunity Fund, LLC* v. *Washington Prime Group, LLC* ("*Cygnus*"), the Delaware Court of Chancery declined to dismiss breach of fiduciary duty claims against the officers of a Delaware limited liability company for failing to make adequate disclosures in connection with a tender offer by the controller and a subsequent squeeze-out of the minority. Specifically, in connection with the tender offer, plaintiffs alleged that the controller and board did not make any recommendation, that the controller disclosed that the consideration might not reflect fair value and that no financial information was provided to the minority. With regard to the squeeze-out merger, the plaintiffs alleged that the related disclosure was missing key information. As the court framed it, the disclosure documents "disclosed *what* the Squeeze-Out Merger was, but did not disclose any information that would explain *how* the Company made its decision or *why* this was an appropriate course of action." Plaintiffs asserted breach of fiduciary duty claims against the board, officers and controllers for the inadequate disclosures, and against the board and controller for approving an unfair transaction. The court dismissed the claims against the board and controller because the relevant LLC agreement contained a fiduciary duty waiver. The waiver did not, however, encompass company officers, and the court denied the dismissal of the breach of the duty of disclosure claims against the officers. Such disclosure duties for an officer, the court concluded, may be analogous to the duties owed by company directors and, depending on the circumstances, may require disclosure in connection with the tender offer, and also in connection with the squeeze-out merger,

"even in the absence of request for action." The court did acknowledge that the officers' "competing duties" to the stockholders in this regard and their duty of obedience to the board created a "conundrum." Nonetheless, the court noted that "[i]t is reasonably conceivable that a duty of disclosure could exist in connection with a severely underpriced tender offer such that fiduciaries for the entity and its investors would have a duty to say something." In addition, the court also denied dismissal of claims against the board, controller and officers for breach of the implied covenant of good faith and fair dealing in connection with their failure to make adequate disclosures about the transactions, failure to seek a vote of the minority under the LLC agreement and providing an inadequately low price in the squeeze-out merger.

Delaware Court of Chancery Upholds Covenant Not to Sue for Breach of Fiduciary Duty
In *New Enterprise Associates 14, L.P.* v. *Rich* ("*New Enterprise Associates*"), the Delaware Court of Chancery, in an opinion by Vice Chancellor Laster, held that a contractual covenant by stockholders not to sue for breach of fiduciary duty in connection with a drag-along sale is enforceable under Delaware law if it is narrowly tailored and reasonable under the circumstances. In doing so, the court cautioned that the case under consideration presented an "optimal" circumstance for enforcement because it involved a clear, specific covenant bargained for by sophisticated parties, and that such provisions may not be enforceable in other contexts. To that end, the court indicated that such a covenant may not be enforced in the case of intentional breach of duty, and thus the court denied the defendants' motion to dismiss with respect to allegations that preferred stockholders acted intentionally and in bad faith to benefit themselves and harm the common stockholders during the lead-up to the challenged drag-along sale.

Delaware Court of Chancery Clarifies that Reopening of Advance Notice Window Requires Activists to Show "Radical Shift" at Company
In *Sternlicht, et al.* v. *Hernandez, et al*. ("*Sternlicht*"), the Delaware Court of Chancery, in an opinion by Vice Chancellor Fioravanti, clarified the high standard that activists must overcome to reopen the director nomination window of an otherwise valid advance notice bylaw – namely, they must show that there has been a "radical shift" in company position caused by the board after the deadline for director nominations had passed. The court held that the plaintiffs did not overcome this standard, despite numerous alleged "radical shifts" that occurred after the deadline. As a result, in a holding favorable for the company, the court enforced the deadline for nominations established by the company's advance notice bylaw and prevented the plaintiffs from nominating a competing slate of directors at the upcoming annual meeting. The opinion strengthens advance notice bylaws as a means of providing certainty around the annual meeting and election process for companies and protecting against activist attacks.

Delaware Court of Chancery Holds That Claims Against SPAC Directors and Sponsor for Breach of Fiduciary Duties Survive Motion to Dismiss
In *Delman* v. *GigAcquisitions3, LLC, et al.* ("*Delman*"), the Delaware Court of Chancery, in an opinion by Vice Chancellor Will, recently held on a motion to dismiss that it was reasonably conceivable that the directors of a special purpose acquisition company ("SPAC") and its sponsor breached their fiduciary duties by disloyally depriving the SPAC public stockholders of information material to their decision on whether to redeem their shares in connection with the deSPAC transaction. Evaluating the claims under the stringent entire fairness standard, the court concluded that the SPAC's sponsor qualified as a controlling stockholder due to its control and influence over the SPAC, even though it held a minority interest, and that the SPAC directors lacked independence from the sponsor. In addition, entire fairness review was warranted based on the divergent interests between the sponsor and public stockholders that are inherent in the SPAC structure, including the sponsor's unique incentive to take a "bad deal" over a liquidation of the SPAC and returning the public stockholders' investment. The opinion provides important key takeaways for sponsors, directors and investors in Delaware SPACs.

Delaware Court of Chancery Dismisses Caremark Claims Against Directors for Failure to Allege Bad Faith Conduct
On March 1, 2023, the Delaware Court of Chancery dismissed *Caremark* oversight claims brought against the directors of McDonald's Corporation for their alleged failure to address "red flags" suggesting widespread sexual harassment and workplace misconduct at the company. In *In re McDonald's Corp. Stockholder Derivative Litigation* ("*McDonald's*"), the court found that the plaintiffs' allegations criticizing the directors' efforts to address such red flags failed to plead that the directors acted in bad faith.

McDonald's reaffirms the vitality of Delaware's strict *Caremark* pleading standard and should help allay recent concerns that it had been diluted.

For the full text of our *Delaware M&A Quarterly* memorandum for Autumn 2023, which contains links to the Delaware Court of Chancery's opinions in each of *Magellan*, *Colon*, *Totta*, *Wilensky* and *Cygnus*, please see:

- https://www.paulweiss.com/media/3983781/delaware_ma_quarterly_autumn_2023.pdf

For the full text of our *Delaware M&A Quarterly* memorandum for Summer 2023, which contains links to the Delaware Court of Chancery's opinions in each of *New Enterprise Associates* and *Sternlicht*, please see:

- https://www.paulweiss.com/media/3983534/delaware_ma_quarterly_summer_2023.pdf

For the full text of our *Delaware M&A Quarterly* memorandum for Spring 2023, which contains links to the Delaware Court of Chancery's opinion in *Delman*, please see:

- https://www.paulweiss.com/media/3983237/delaware_ma_quarterly_spring_2023.pdf

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

- https://courts.delaware.gov/Opinions/Download.aspx?id=344560

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

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