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# PUBLIC COMPANY UPDATE

JANUARY 21, 2021

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# INTRODUCTORY REMARKS

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# MERGER LITIGATION

Jon Bergman  
Tess Hand-Bender

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# MERGER LITIGATION: THE PROBLEM

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- In 2017, 85% of all completed mergers were challenged in lawsuits (Cain, *et al.*, *The Shifting Tides of Merger Litigation*, 71 Vand. L. Rev. 603, 608 (2018))
- During the first half of 2020, a single group of lawyers filed over 50 M&A deal challenges
- Federal courts are favored
- Delaware Chancery Court is avoided
  - *In re Trulia Inc. Stockholder Litig.*, 129 A.3d 884 (Del. Ch. 2016) (strong policy disfavoring merger litigation settlements without a meaningful benefit to shareholder)
  - *Corwin v. KKR Fin. Holdings LLC* (Del. Sup. 2015) (fully informed vote of disinterested, uncoerced stockholders effectively extinguishes breach of fiduciary duty claims, leaving only claims for waste)

# MERGER LITIGATION: OPENING MOVES

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- Merger Finalized
  - Filing of Registration Statement/Joint Proxy Statement (“Proxy”)
  - Public announcement
- Merger Strike Lawsuits Filed
  - Content and claims are remarkably similar

# MERGER LITIGATION: ANATOMY OF A COMPLAINT

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## Core assertion: Proxy is misleading and omits information

- Typical allegations:
  - Inadequate financial projections/metrics
  - Omitted details about merger negotiations
  - Purported conflicts of interest by directors and officers
  
- Typical legal claims:
  - Violations of Sections 14(a) and 20(a) of the Securities Exchange Act of 1934
  - Breaches of fiduciary duties
  - Class action status
  
- Typical relief sought:
  - Injunctive relief
  - Rescission
  - Damages
  - Corrective disclosures

# MERGER LITIGATION: KEY DECISIONS

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- Plaintiff's decision node:
  - Seek to enjoin merger, litigate, or settle
- Defendants' decision node:
  - Litigate or seek to resolve

# MERGER LITIGATION: SETTLEMENT PATH

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- “Moot me” overture
- Company issues “corrective” disclosures
  - Voluntary
  - Not an admission
  - Proxy is fully compliant with laws and regulations
- Memorandum of understanding or other agreement
  - Lawsuits dismissed
  - Individual claims released

- Capture Corporation
  - Fictional, publicly traded company
- ACME Corporation
  - Fictional provider of choice for Wile E. Coyote (*e.g.*, exploding bird seed)

# MERGER LITIGATION AND APPRAISAL RIGHTS

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# IPO ALTERNATIVES

John Elofson

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# CRITICISMS OF TRADITIONAL IPOs

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- Cost
  - Underwriter fees
  - The “pop”
- Lengthy process with certain costs and uncertain valuation
- Does diligence process work?
- Process now geared towards “unicorns” rather than smaller, earlier-stage companies

- SPACs – “special purpose acquisition companies” were huge in 2020
- Proceeds raised in SPAC IPOs rose from \$4B in 2015 to \$14B in 2019 to \$41B in 2020
- Notable 2020 SPAC mergers include DraftKings, Virgin Galactic, and Nikola

# WHAT IS A SPAC?

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- A company that goes public with no assets other than cash; cash is held in trust until the company makes an acquisition
- SPAC sponsor typically receives 20% of the company's stock for nominal investment (the "promote") to compensate it for organizational efforts
- SPAC sponsors and outside investors also receive warrants
- If no acquisition is completed by a deadline, the cash is returned to investors

# WHAT IS A DE-SPAC TRANSACTION?

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- A de-SPAC transaction occurs when the SPAC merges with a private company, effectively resulting in an IPO of the private company
- SPAC investors can redeem their shares for a pro rata share of the trust, even if they vote in favor of the merger
- Because the amount of redemptions are unknown, the SPAC may also sell shares in a PIPE transaction to ensure that the post-merger company will have sufficient cash

# PROS AND CONS

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## ■ Pros

- May be available for smaller companies and in volatile market conditions
- May provide increased valuation certainty
- Founders may be better gatekeepers?

## ■ Cons

- Can result in major dilution to outside investors who don't redeem, in particular due to the sponsor "promote" and redemptions
  - Some SPACs have recently gone public with more investor-friendly terms
- SPAC founders have conflicts of interest resulting from SPAC deal deadline
- Valuation certainty may be less than it appears

- Company's initial registration statement is for resales by existing holders
- No underwriters, but initial price determined by financial advisor and a designated market maker based on pre-opening orders
- Avoids some of the valuation issues associated with traditional IPOs
  - NYSE rule change to permit sales by the company recently approved; similar Nasdaq rule proposed
  - Sales by the company must be effected pursuant to a specified auction process
- Some high-profile examples – Spotify, Slack and Palantir – but no major wave of deals

# IPO ALTERNATIVES

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# CURRENT CORPORATE GOVERNANCE AND DELAWARE LAW ISSUES, AND A SEC UPDATE

Kristin Lentz  
Sam Seiberling  
Lee Terry

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# MODERNIZATION RULES

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- Goal was to simplify compliance efforts by registrants
- Shift towards a principle-based disclosure framework
- August 2020 amendments affected the following:
  - Description of business
  - Legal proceedings
  - Risk factors
- November 2020 amendments affected the following:
  - Selected financial data; supplementary financial information
  - Contractual obligations
  - Off-balance sheet arrangements
  - Other financial disclosure requirements
- Amendments affecting Rule 14a-8 (shareholder proposals)

# MODERNIZATION RULES – AUGUST 2020

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- Description of business (Item 101)
  - Requires only an update of material developments to the business since most recent full discussion
  - Five-year timeframe replaced with materiality framework
  - New required disclosures regarding human capital resources
  - Required disclosure: material effects that compliance with all government regulations (not just environmental) have on registrant
- Legal proceedings (Item 103)
  - Expressly permits cross-reference to legal proceedings disclosure in other parts of filing
  - Thresholds for governmental environmental proceedings; up to \$300k from \$100k; or allow registrant to choose its own threshold (so long as it's less than \$1mm or 1% of assets and threshold is disclosed)
- Risk factor disclosures (Item 105)
  - If risk factor section exceeds 15 pages, must have summary risk factor disclosure (<2 pages)
  - Requires risk factors to be organized under relevant headings and not just subcaptions
- Effective November 9, 2020

# MODERNIZATION RULES – NOVEMBER 2020

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- Amendment Highlights:
  - Eliminated Selected Financial Data and the tabular disclosure of contractual obligations
  - Supplementary Financial Information—“material retrospective changes” rather than two years of tabular selected quarterly financial data
  - Off-Balance Sheet Arrangements—must discuss commitments/obligations (including contingent) that have/reasonably likely to have material effect on financial condition, revenues/expenses, results of operations, etc.
  - Capital Resources—provide material cash requirements, anticipated sources, purposes
  - Results of Operations—need to discuss material changes (rather than just increases) in net sales/revenues
  - Interim Periods—can compare recently completed quarter with either previous year’s quarter or immediately preceding quarter
- Effective February 10, 2021, but compliance is not required until fiscal years ending after August 9, 2021. Early adoption is permitted.

# MODERNIZATION RULES – SHAREHOLDER PROPOSALS

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- Rule 14a-8(b)
  - New ownership threshold to make a proposal: \$2k for 3 years, \$15k for 2 years, \$25k for 1 year
  - No aggregation of holdings with other shareholders
  - Must document representative’s authority to represent shareholders
  - Proponent must be available to meet with company; provide dates, times, and contact information
- Rule 14a-8(c)
  - Only one proposal per person (rather than shareholder)
- Rule 14a-8(i)(12)
  - Increased resubmission thresholds for previous proposals:
    - Was 3%, 6%, and 10% for matters voted on once, twice, or three+ times, respectively
    - Now 5%, 15%, and 25%
- Effective for meetings held on or after January 1, 2022

# ELECTRONIC SIGNATURES FOR SEC FILINGS

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- Now permits electronic signatures in connection with EDGAR filings
- Prior to initial electronic signature, signatory must sign attestation document (kept on file with the company while the digital signature is used and for seven years thereafter)
- Electronic signature process must:
  - Require a credential that authenticates the signatory's identity
  - Reasonably provide non-repudiation of signature
  - Attach, affix or associate the signature to the signature page or document being signed
  - Be timestamped
- Effective December 4, 2020

# ACCREDITED INVESTOR DEFINITION

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- New ways to qualify as Accredited Investor:
  - Certain professional certifications (i.e. Series 7, Series 82, Series 65)
  - Investment advisers registered with SEC, state, or exempt reporting advisers
  - “Knowledgeable employees” of a private fund
  - Family offices with >\$5mm AUM; plus such family offices’ clients
  - Rural business investment companies
  - Catch-all: entities with (a) investments >\$5mm, (b) not formed for specific purpose of acquiring the securities, and (c) not otherwise covered by the accredited investor definition
- Effective December 8, 2020

# DISCLOSURE OF PAYMENTS BY RESOURCE EXTRACTION ISSUERS (OIL & GAS AND MINING)

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## **2016 Rule Disapproved by Congress**

- Section 13(q) requires SEC to pass rules requiring resource extraction issuers to disclose payments made to US or foreign government for purpose of commercial development of resources projects
- USDC in DC vacated 2012 Rules in 2013
- June 2016 Rules tracked similar EU & Canada rules, including expansive definitions of “project” and “control”
- 2016 Rules were disapproved by both houses of Congress under CRA as too expensive and burdensome

## **New Rules Adopted in December 2020**

- Add conditional exemptions for when foreign law or preexisting contracts prohibit the required disclosure
- Add exemption for smaller reporting companies and emerging growth companies
- Revises the definition of “control” to exclude proportionate interests in entities or operations

## Rule 144 Updates

- Electronic filing
- Same due date as Form 4s
- Holding period for conversions of securities not listed on exchange
- No Form 144 for non-1934 Act securities

## Rule 701 Amendments

- Extends eligibility to consultants and advisors when securities linked to performance of services to former employees for post-termination grants and former employees of acquired entities
- Revises additional disclosure requirements for sales over \$10 million
- Revises disclosure delivery requirements for new hires
- Raises two of the three alternative caps that may be sold in any 12-month period
- Makes exemption available for written compensatory benefit plan or contract of non-majority owned subsidiaries

# PROPOSED CHANGES TO FORM S-8

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- Extends eligibility to consultants and advisors when securities linked to performance of services, to former employees for post-termination grants and to former employees of acquired entities
- Confirms ability to include multiple plans
- Permits adding securities or classes of securities by automatically effective post-effective amendment
- Conforms Form S-8 instructions with current IRS plan review practices
- Eliminates requirement to describe the tax effects on the issuer

# SEC ENFORCEMENT

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- Last 4 years have seen decline in “broken windows” cases, pursuit of large investment banks, multinational corporations and, most recently, curtailing of amounts payable to whistleblowers
- New SEC Chair nominee Gary Gensler spent 18 years at Goldman Sachs, worked in Treasury Department under Clinton administration, chaired CFTC under Obama until 2014, economic adviser for Hillary Clinton 2016 campaign and has led Biden transition financial regulatory team
- Not a Wall Street choice (Sen. Warren “gushed” over choice)
- Expect more broken windows cases and creative uses of nondisclosure laws to attack unpopular/undesirable business practices
- Hard to read tea leaves on crypto

# FEDERAL FORUM SELECTION PROVISIONS

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- *Salzberg v. Sciabacucchi, 227 A.3d 102 (Del. 2020).*
- The Securities Act of 1933 creates a private right of action that allows purchasers, subject to certain exceptions, to sue in federal or state court.
- In 2018, the U.S. Supreme Court ruled that if a claim is brought in state court, it cannot be removed to federal court.
  
- Key Points
  - Federal forum selection provisions in a company’s certificate of incorporation were upheld; unsettled if this would also apply to a provision in a company’s bylaws.
  - The provisions in question only required suits to be brought in a federal district courts; it did not specify a specific federal district court.
  - State courts will still determine if federal forum selection provisions are enforceable.

# NO MAE DUE TO COVID-19

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- *AB Stable VIII LLC v. MAPS Hotels and Resorts One LLC (Nov. 30, 2020).*
- The Delaware Court of Chancery held that the COVID-19 pandemic did not result in a material adverse effect (“MAE”) on a target because pandemics fall within the plain meaning of the MAE’s exception for natural disasters and calamities.
- The court held that the buyer could still terminate the agreement because the seller had breached the ordinary course covenant by operating inconsistently with past business practices.

# DIRECTOR OVERSIGHT DUTY

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- *Teamsters Local 443 Health Services & Insurance Plan, et al. v. John G. Chou, et al. (Del. Ch. Aug. 24, 2020).*
- The Delaware Court of Chancery held that directors breached their fiduciary duties by ignoring red flags, failing to implement compliance policies and systems, and failing to exercise their oversight responsibilities.
- The three red flags were (i) a report prepared by outside counsel that identified substantial gaps in a subsidiary's critical compliance mechanisms; (ii) a *qui tam* suit by the subsidiary's COO which alleged details of the problematic activity; and (iii) a subpoena served by the DOJ on the subsidiary.
- The court drew a reasonable inference of board knowledge because each of the red flags was either disclosed directly to the directors or was referenced in SEC filings.

# PROPOSED NASDAQ DIVERSITY RULES

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- The rules proposed December 1, 2020 would require certain Nasdaq-listed companies to:
  - Annually disclose diversity statistics regarding their directors’ voluntary self-identified characteristics in substantially the format proposed by Nasdaq for the current year and (after the first year of disclosure) the immediately prior year.
  - Include on their boards of directors at least two “Diverse” directors (as defined in the rules) or publicly disclose why their boards do not include such “Diverse” directors.

# CALIFORNIA DIVERSITY RULES

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- On September 30, 2020, California Governor signed AB 979 into law. AB 979 requires the following:
  - By the end of 2021, California-headquartered publicly held & listed companies must have at least one director on Board from “underrepresented community” (Black, Latino, Asian, Pacific Islander, Native American, Native Hawaiian, Alaska Native, gay, lesbian, bisexual, or transgender)
  - Deadline is 12/31/2022, or pay \$100K fine “[f]or failure to timely file board member information” for 1st violation and \$300,000 for subsequent violation.
  - In addition to 2018 California requirement to have one female director on Board by 12/31/2019 and for larger Boards, more by 12/31/2021

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# EXECUTIVE COMPENSATION UPDATE

Elizabeth Vonne  
Jonathan Marks

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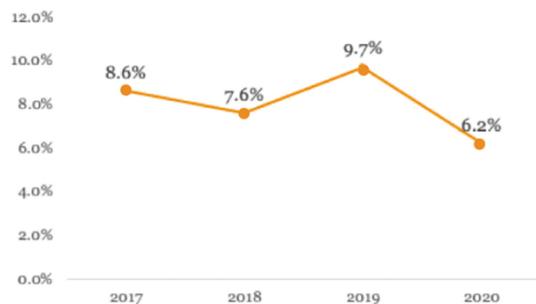
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## 1. Management Carveouts

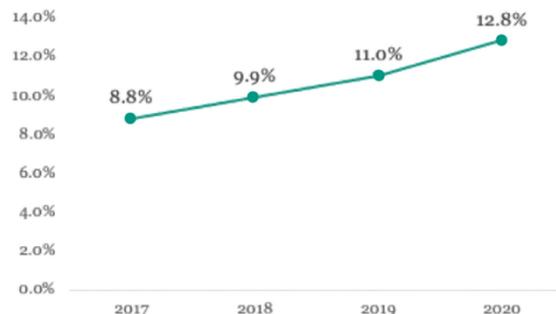
## 2. Options Assumption

<https://www.srsacquiom.com/resources/m-a-transactions/>

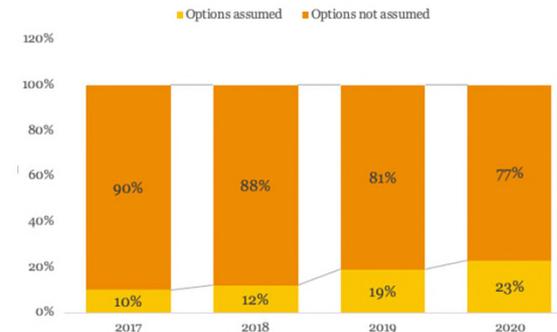
**MANAGEMENT CARVEOUTS: FREQUENCY**  
Deals Including a Management Carveout



**MANAGEMENT CARVEOUTS: SIZE**  
Median Size as a Percentage of Transaction Value



**TREATMENT OF OPTIONS: ASSUMPTION**  
Assumption of Options by Buyer



# ISS: CASH AND EQUITY COMPENSATION ISSUES FOR 2021 PROXY STATEMENT

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1. Equity Plan Scorecard: The passing score for the S&P 500 EPSC model will increase to 57 points. The passing score for the Russell 3000 EPSC model will increase to 55 points. For all other EPSC models, the passing score will remain 53 points.
2. Say-on-pay and COVID-19: ISS may tolerate companies that receive less than 70% support but are unable, due to the pandemic, to take actions or make changes to pay programs and practices to address concerns.
3. COVID-Related One-Time Awards: Companies granting one-time awards to address concerns resulting from the pandemic, including awards with a retention component, should clearly disclose the rationale.
4. One-Time Awards Granted to Replace Forfeited Incentives: ISS disapproves awards granted as a replacement for forfeited underperforming performance-based awards.
5. Option Repricing: Still opposes repricings after drop in stock price. If boards do not seek prior shareholder approval, the directors' actions will remain subject to ISS scrutiny.

# Lawsuits Seek to Hold Directors Liable For Public Statements on D&I

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Complaints allege that despite public statements emphasizing the importance of diversity, the boards and executive management teams of Oracle, Facebook, and Qualcomm, remain largely white and male, and have failed to deliver on their commitments to diversity.

Can statements on ESG principles form the basis of an actionable misstatement claim?

Recognize that accountability for diversity and inclusion statements may be a public relations, government enforcement, and litigation issue.

Complaint, Klein v. Ellison, Case No. 20-cv-4439 (N.D. Cal. July 2, 2020); Complaint, Ocegueda v. Zuckerberg, Case No. 20-cv-04444 (N.D. Cal. July 2, 2020); Complaint, Kiger v. Mollenkopf, Case No. 20-cv-01355-LAB-MDD (S.D. Cal. July 17, 2020)

# PERQUISITES – COVID CD&I

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## ■ CD&I 219.05

In reporting compensation for periods affected by COVID-19, questions may arise whether benefits provided to executive officers because of the COVID-19 pandemic constitute perquisites or personal benefits for purposes of the disclosure required by Item 402(c)(2)(ix)(A) and determining which executive officers are “named executive officers” under Item 402(a)(3)(iii) and (iv). The two-step analysis articulated by the Commission in Release 33-8732A continues to apply when determining whether an item provided because of the COVID-19 pandemic constitutes a perquisite or personal benefit.

- An item is not a perquisite or personal benefit if it is integrally and directly related to the performance of the executive’s duties.
- Otherwise, an item that confers a direct or indirect benefit and that has a personal aspect, without regard to whether it may be provided for some business reason or for the convenience of the company, is a perquisite or personal benefit unless it is generally available on a non-discriminatory basis to all employees.

Whether an item is “integrally and directly related to the performance of the executive’s duties” depends on the particular facts. In some cases, an item considered a perquisite or personal benefit when provided in the past may not be considered as such when provided as a result of COVID-19. For example, enhanced technology needed to make the NEO’s home his or her primary workplace upon imposition of local stay-at-home orders would generally not be a perquisite or personal benefit because of the integral and direct relationship to the performance of the executive’s duties. On the other hand, items such as new health-related or personal transportation benefits provided to address new risks arising because of COVID-19, if they are not integrally and directly related to the performance of the executive’s duties, may be perquisites or personal benefits even if the company would not have provided the benefit but for the COVID-19 pandemic, unless they are generally available to all employees.

# PERQUISITES – ENFORCEMENT ACTIVITY

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## Enforcement Actions

- Hilton (Sep 30, 2020)
  - \$600,000 penalty
  - Failure to disclose approximately \$1.7MM in total value
- Argo Group (June 4, 2020)
  - \$900,000 penalty
  - Failure to disclose approximately \$5.3MM in total value
- RCI Hospitality (Sep 21, 2020)
  - \$635,000 in total penalties, some directly against the CEO and CFO
  - Failure to disclose approximately \$615,000 in total value

## Disclosure Failures

- Corporate Aircraft
- Hotel Stays
- Helicopter Trips
- Transportation for Family Members
- Personal Services
- Club Memberships
- Tickets and transportation to entertainment events
- Company provided vehicles
- Meals and housing costs
- Charitable contributions to private schools of CEO

## PERQUISITES – LESSONS

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- Hot button issue for SEC and some stockholders
- Bolster internal controls
- Look at D&O questionnaires
- Use common sense

# COVID – ANNUAL BONUS PLANS

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- COVID significantly affected annual bonus plans:
  - Addition of discretion
  - Change of performance period
  - Reduced payout opportunity
  - Delayed goal setting
  - New and/or modified performance metrics
  - Cancellation of plans
  - Payment in stock vs. cash

## ISS Position

- Compensation still subject to standard quantitative screen.
- For qualitative screening purposes, ISS may view actions related to annual incentive plans as reasonable under the circumstances, so long as the justifications and rationale are clearly disclosed, and the outcomes seem reasonable
- Lower performance expectations that reflect external factors may be reasonable explanation for lower goal setting under annual incentive plans, assuming appropriate disclosure of how the Board considered payout opportunities.

## Recommended Disclosure

- The specific challenges that were incurred as a result of the pandemic and how those challenges rendered the original program design obsolete or the original performance targets impossible to achieve. The disclosure should address how changes are not reflective of poor management performance.
- For companies making mid-year changes vs. discretionary bonuses, the company should explain why that approach was taken (as opposed to the alternative approach) and how such actions further investors' interests.
- Discretionary bonuses should still carry performance-based considerations and companies should disclose the underlying criteria, even if not based on the original metrics or targets. Investors are likely to find generic descriptions (i.e. "strong leadership during challenging times") to be insufficient.
- The company should discuss how the resulting payouts appropriately reflect both executive and company annual performance. The disclosure should clarify (or estimate) how the resulting payouts compare with what would have been paid under the original program design. Above-target payouts under changed programs will be closely scrutinized.
- Companies that have designed the following year's (2021) annual incentive program are encouraged to disclose information about positive changes, which may carry mitigating weight in ISS' qualitative evaluation.

# COVID – BASE SALARY REDUCTIONS

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## General

- Temporary salary reductions for executives were very common in 2020
- Many companies have reinstated or are planning to reinstate salaries to pre-pandemic levels.

## ISS Position

- Included in standard quantitative screen
- May be given marginal weight in qualitative screen, with additional weight provided if accompanied by decrease in target incentive opportunities

# MISCELLANEOUS COMPENSATION ITEMS

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- Pay Ratio – Identify new median employee?
- Equity plan share reserves
- Other

# EXECUTIVE COMPENSATION UPDATE

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