Cravath Quarterly Review

M&A, ACTIVISM AND CORPORATE GOVERNANCE

01

Mergers & Acquisitions

TRENDS[1]

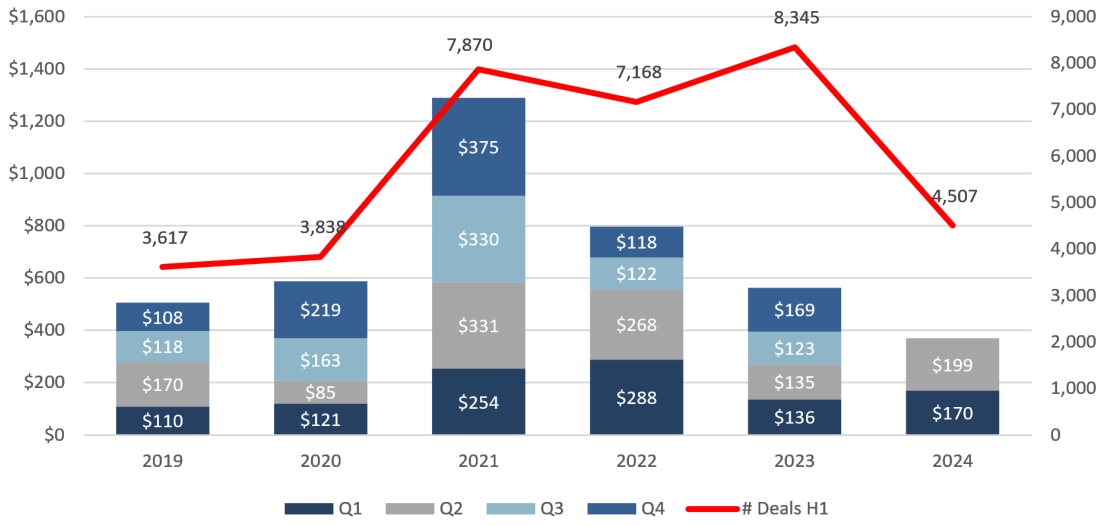
SOURCE Refinitiv, An LSEG Business.

H1 2024: M&A Volume Increases Year-over-Year, Announced Deal Volume Below $1 Trillion for Eighth Consecutive Quarter

Global M&A volume increased 18% in H1 2024 compared to H1 2023, with $1.5 trillion in announced deal volume, representing a decrease of ~4% compared to H2 2023. Q2 2024, with announced deal volume of $719 billion, marked the eighth consecutive quarter to fall below $1 trillion in announced deal volume. Around 23,200 deals were announced in H1 2024, a decrease of ~25% compared to H1 2023's over 30,000 deals and a decrease of ~14% compared to H2 2023's over 27,000 deals.

Global Private Equity Buyouts – Deal Volume

($ in billions)

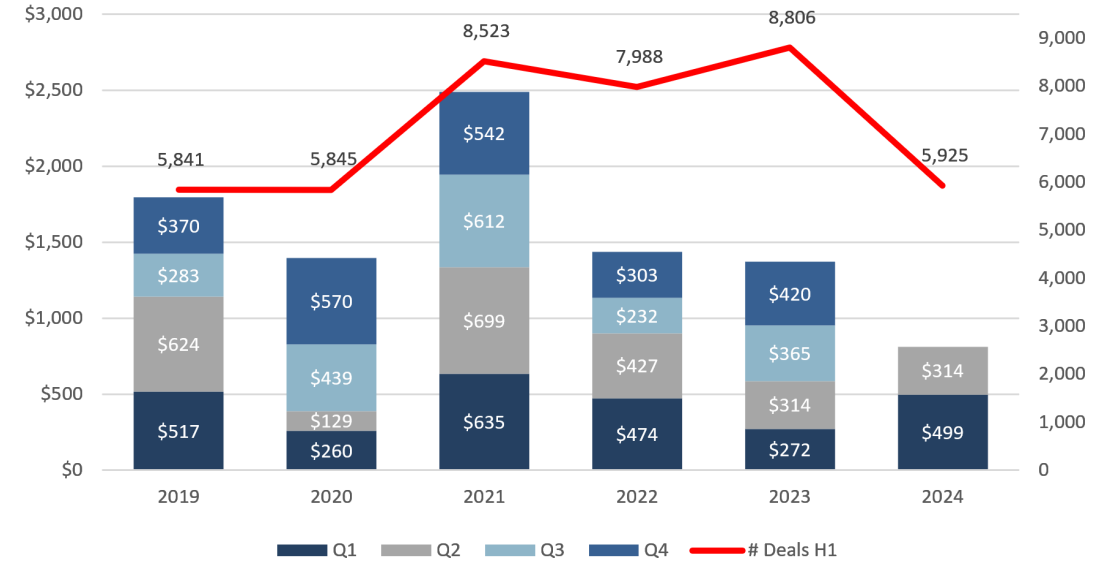


SOURCE Refinitiv, An LSEG Business.

Private equity buyouts in H1 2024 reached $369 billion globally, an increase of ~36% compared to H1 2023 and an increase of ~26% compared to H2 2023. Slightly over 4,500 private equity-backed deals were announced in H1 2024, a decrease of ~46% compared to H1 2023's over 8,300 deals and a decrease of ~26% compared to H2 2023's over 6,000 deals.

U.S. Quarterly Deal Volume

($ in billions)



SOURCE Refinitiv, An LSEG Business.

Dealmaking Up in U.S. and Europe

M&A activity for U.S. targets amounted to $813 billion in H1 2024, an increase of ~39% compared to H1 2023 and an increase of ~4% compared to H2 2023. M&A activity for European targets totaled $343 billion in H1 2024, an increase of ~39% compared to H1 2023 and an increase of ~2% compared to H2 2023, marking a two-year high. In the Asia-Pacific region, dealmaking experienced the slowest first half since 2013, totaling $226 billion in H1 2024, a ~24% decrease compared to H1 2023 and a ~27% decrease compared to H2 2023. Cross-border M&A activity totaled $505 billion in H1 2024, a ~15% increase compared to H1 2023 and a ~10% increase compared to H2 2023, marking the strongest first half for cross-border M&A in two years.

LEGAL & REGULATORY DEVELOPMENTS

Cases

Q2 2024 featured a number of notable decisions by Delaware courts.

CONTROLLING STOCKHOLDER

IN RE MATCH GROUP, INC. DERIVATIVE LITIGATION, C.A. NO. 2020-0505 (DELAWARE SUPREME COURT, APRIL 4, 2024)

In April 2024, the Delaware Supreme Court held that entire fairness review applies to all transactions, not just freeze-out merger transactions, where a controlling stockholder stands on both sides and receives a non-ratable benefit. To be entitled to business judgment review, such a transaction must meet the protections set out in *MFW vs. M&F Worldwide Corp.*[2] —the transaction must be approved by (1) a fully independent and disinterested special committee and (2) a majority of votes cast by uncoerced, fully informed and unaffiliated minority stockholders (clauses (1) and (2), the "*MFW* protections"). The Court further held that, in order for a special committee to satisfy this test, all members of the special committee must be independent and disinterested.

In 2019, IAC/InterActiveCorp ("IAC") separated from its controlled subsidiary, Match Group, Inc. ("Match"), via a reverse spinoff. The transaction was approved by a special committee appointed by IAC. Minority stockholders of Match filed suit in the Delaware Court of Chancery, alleging that the transaction was unfair because IAC received benefits at the expense of the minority stockholders. The Court of Chancery applied the business judgment rule and dismissed the plaintiffs' complaint, holding that IAC satisfied the requirements of the *MFW* protections. Although the Court of Chancery agreed that it was reasonably conceivable that one of the three members of the special committee lacked independence, it held that the special committee was independent because the plaintiffs failed to show that either "50% or more of the special committee was not disinterested and independent" or the non-independent minority of the special committee "somehow infect[ed]" or "dominat[ed]" the committee's decision-making process.

On appeal, the Delaware Supreme Court rejected the defendants' argument that the *MFW* framework only applies to freeze-out merger transactions, holding that the *MFW* framework applies to all controlling stockholder transactions where the controller receives a non-ratable benefit. The Court further held that to satisfy the *MFW* protections, each member of the special committee must be independent and disinterested. Since the Court agreed that the plaintiffs pleaded sufficient facts to support a reasonable inference that one member of the special committee was not independent, it held that the defendants failed to satisfy the *MFW* protections. The Delaware Supreme Court reversed the Court of Chancery's dismissal of the plaintiffs' claims and remanded the case for further proceedings.

FIDUCIARY DUTIES

MCRITCHIE V. ZUCKERBERG ET AL., C.A. NO. 2022-0890-JTL (DEL. CH. APRIL 30, 2024)

In April 2024, the Delaware Court of Chancery rejected the diversified-investor model—the theory that the law must operate on the assumption that a corporation's stockholders are diversified—and reaffirmed that the directors of a corporation owe fiduciary duties only to the stockholders of a specific corporation in their capacities as such.

A stockholder of Meta Platforms, Inc. ("Meta") claimed that Meta directors breached their fiduciary duties to the Meta stockholders by managing Meta "in a manner that ignores the interests" of Meta's "diversified" stockholders. The plaintiff argued that the directors of Meta are concentrated owners of Meta stock that would benefit if Meta outperforms the market, while Meta's public shareholders are broadly diversified institutional investors. The plaintiff contended that by maximizing Meta's performance and their concentrated holdings, the directors generated negative externalities on the economy, society and the portfolios of diversified investors.

The Court of Chancery dismissed the claim, holding that the principle of firm-specific fiduciary duties is "so basic that no Delaware decisions have felt the need to say it. Fish don't talk about water." It examined past Delaware Supreme Court opinions, finding that, "by necessary implication", directors only owe fiduciary duties to firm-specific stockholders "in their capacity as firm-specific stockholders and not in any other capacities they may have."

CONFLICT DISCLOSURE

CITY OF SARASOTA FIREFIGHTERS' PENSION FUND ET AL. V. INOVALON HOLDINGS, INC. ET AL. (DELAWARE SUPREME COURT, MAY 1, 2024)

In May 2024, the Delaware Supreme Court reversed the Court of Chancery's dismissal of stockholders' challenges to an acquisition under the *MFW* framework, allowing the claims to proceed due to inadequate disclosure of the special committee's advisors' conflicts of interest in the proxy statement.

The case arose from the acquisition of public company Inovalon Holdings, Inc. ("Inovalon") by a consortium led by Nordic Capital ("Nordic"). Because of Inovalon's dual-class capital structure, the founder and CEO of Inovalon controlled 64.1% of Inovalon's total voting power, while a former Inovalon director controlled roughly 23%. On April 20, 2021, Nordic contacted Inovalon regarding a potential acquisition, which required an equity rollover of shares held by the CEO and the former director. Inovalon's board subsequently formed a special committee. The special committee engaged the same legal advisor that was advising Inovalon on the acquisition, as well as two financial advisors that had previously worked with Nordic or other consortium members and were concurrently advising several consortium members on other matters. The financial advisors failed to disclose all such prior engagements to the special committee until after the parties had signed the transaction agreement. The special committee, the independent directors and the audit committee eventually approved the transaction, and over 99% of Inovalon's minority shareholders voted to approve the transaction.

Dissenting stockholders brought breach of fiduciary claims against Inovalon's board following the approval of the transaction. The Delaware Court of Chancery granted the defendants' motion to dismiss, finding that the *MFW* protections of approval by an independent and disinterested special committee and an uncoerced, fully informed vote of minority stockholders had been satisfied. The Delaware Supreme Court reversed the ruling on the basis that the minority stockholders were not fully informed due to inadequate disclosure of the financial advisors' conflicts in the proxy statement, holding that (1) the proxy statement's reference that the special committee's second

financial advisor "may provide" services to members of the consortium was misleading, since the advisor was actually providing such services; (2) the proxy statement only disclosed that the special committee's first financial advisor was concurrently representing two separate consortium members and receiving "customary compensation", without providing information to allow stockholders to compare the size of fees from these engagements necessary for "contextualizing and evaluating" the advisor's conflicts; and (3) the proxy statement failed to adequately disclose the first financial advisor's nearly $400 million in fees from prior engagements with members of the consortium.

This case continues a recent trend of increased scrutiny of perceived conflicts and disclosure in the context of controlling stockholder transactions.

ENTIRE FAIRNESS

FIREFIGHTERS' PENSION SYSTEM OF THE CITY OF KANSAS CITY, MISSOURI TRUST V. FOUNDATION BUILDING MATERIALS, INC., C.A. NO. 2022-0466-JTL (DEL. CH. MAY 31, 2024)

In May 2024, the Delaware Court of Chancery declined to dismiss several fiduciary duty claims brought against the directors, special committee and controlling stockholder of Foundation Building Materials, Inc. ("FBM"). It also declined to dismiss a claim for violation of the appraisal statute of the Delaware General Corporation Law (the "DGCL"), which entitles stockholders to twenty days after an appraisal notice to demand appraisal. The claims arose from the sale of FBM to a subsidiary of American Securities LLC ("American").

In 2015, private equity fund Lone Star Fund ("Lone Star") acquired FBM in a going-private transaction and took it public again less than eighteen months later. Lone Star owned 65.4% of FBM's outstanding voting power after the IPO. In connection with the IPO, Lone Star and FBM entered into a tax receivable agreement (the "TRA") that entitled Lone Star to a payment equal to 90% of the tax benefits FBM received from using a tax asset generated while FBM was a private company. Upon a change of control of FBM, Lone Star had the right to terminate the TRA and receive a lump sum early termination payment, calculated with valuation assumptions favoring Lone Star. After the Tax Cuts and Jobs Act of 2017 (the "Tax Act") came into effect, the reduced federal corporate income tax rate reduced the value of FBM's corporate tax assets by 40%, making the lump sum early termination payment more valuable to Lone Star in comparison. In early 2018, Lone Star began to explore options for a sale of FBM, eventually selling FBM to a subsidiary of American in 2020. Stockholders of FBM then brought suit to challenge the sale.

The Court dismissed some of the stockholders' claims and allowed other claims to proceed. Among other findings, (1) the Court declined to dismiss the claim that Lone Star breached its fiduciary duties by pursuing a sale rather than continuing the operation of FBM, holding that entire fairness was the applicable standard because Lone Star received a non-ratable benefit from the early termination payment under the TRA, particularly after the Tax Act reduced the stream of contractual payments expected; (2) the Court declined to dismiss the fiduciary duty claim against the special committee of FBM, holding that the plaintiffs' complaint sufficiently pleaded that the special committee breached its fiduciary duties by deferring to Lone Star and not taking an active role in the sale process; (3) the Court declined to dismiss the claim that the financial advisors of FBM and its special committee aided and abetted the breach, pointing to the contingent fee structure that includes a percentage of the early termination payment; and (4) the Court declined to dismiss the claim that the appraisal notice given in connection with the merger did not give stockholders the statutorily required twenty days to demand appraisal, holding that since the formal appraisal notice was dated and

mailed "on or about" December 4, 2020 and stated a deadline of December 24, 2020, it was reasonably conceivable that the appraisal notice may have been mailed to some stockholders after December 4.

Delaware Corporate Law Amendments

In June 2024, the Delaware legislature voted to pass amendments to the DGCL that were largely designed to address the outcome of recent Delaware Chancery Court decisions in *Crispo v. Musk*,[3] *West Palm Beach Firefighters' Pension Fund v. Moelis & Company*[4] and *Sjunde AP-fonden v. Activision Blizzard*.[5] The Delaware House and Senate passed the amendments notwithstanding some criticism from legal academics and jurists regarding both the substance of the amendments and the amendment process.[6] The amendments were signed into law by the Governor of Delaware on July 17, 2024, and will become effective on August 1, 2024.[7]

Reacting to the outcome in *Moelis* (invalidating certain stockholder consent and board composition-related rights in a stockholder agreement with the company's founder), the amendments will allow a corporation to enter into contracts with current or prospective stockholders whereby the corporation agrees, among other things, to (i) restrict itself, the board or one or more directors from taking specified actions or (ii) require approval from one or more persons or entities before taking specified corporate actions. Such contracts cannot confer governance powers beyond what could be included in the charter or what would be permissible under Delaware law. The amendments require that the corporation receive consideration for entering into such contracts, and such consideration may include inducing stockholders to take or refrain from certain actions. The amendments do not allow the directors to over-delegate their authority to manage the corporation, nor do they alter the fiduciary duties or current standards of review with respect to a board's decision to enter into such contracts.

In response to the outcome in *Crispo* (narrowing the enforceability of lost-premium provisions), the amendments will allow parties to a transaction agreement to contract for lost-premium damages provisions, regardless of provisions of contract law that would make them otherwise unenforceable, such as those pertaining to liquidated damages. The amendments also expressly enable the appointment of stockholder representatives to enforce the rights of stockholders, including rights to payments of merger consideration, under a transaction agreement.

In response to the outcome in *Activision* (requiring the transaction agreement and related disclosure schedules to be finalized prior to obtaining approval), the amendments provide that, where the DGCL requires a board to approve an agreement, the agreement must be in either final form or substantially final form. "Substantially final form" requires that all material terms are present or determinable through other information known by the board. The amendments also allow the board to ratify an agreement after it was previously approved and provide that such ratification will be deemed effective as of the time of original approval as long as the ratification takes place before the agreement is filed with the Secretary of State. In addition, the amendments provide that, unless the applicable transaction agreement expressly states otherwise, disclosure letters and disclosure schedules will not be deemed to be part of the transaction agreement for purposes of the DGCL and instead will have the effects specified by the contracting parties in the applicable agreement.

02

Antitrust

ENFORCEMENT

Federal Trade Commission

In April 2024, the Federal Trade Commission ("FTC") sued to block an $8.5 billion acquisition of Capri Holdings Limited ("Capri") by Tapestry Inc. ("Tapestry").[8] The FTC alleged that Tapestry's Coach and Kate Spade brands and Capri's Michael Kors brand are close competitors, especially in the "accessible luxury" space, and that "[t]he deal would eliminate fierce head-to-head competition on many important attributes including on price, discounting, and design."[9]

In May 2024, the FTC and Exxon Mobil Corporation ("Exxon") agreed to a consent order to resolve Exxon's $64.5 billion acquisition of oil producer Pioneer Natural Resources ("Pioneer"). The consent order bans Pioneer's former CEO and founder from sitting on Exxon's board of directors or serving as an advisor to Exxon, following the FTC's allegations that he had previously "attempted to collude ... to reduce output of oil and gas."[10] After reaching the consent agreement with the FTC, Exxon announced it had completed its acquisition of Pioneer.[11]

Department of Justice

In April 2024, insulation and building material supplier TopBuild Corp. ("TopBuild") announced it was abandoning its proposed $960 million acquisition of mechanical insulation supplier Specialty Products & Insulation ("SPI") from private equity firm Incline Equity Partners.[12] The termination decision came after the Department of Justice ("DOJ") raised concerns that the acquisition would harm competition in the building insulation market, "combining two of the largest providers" and "eliminat[ing] fierce head-to-head competition between them."[13]

Also in April 2024, two directors of Warner Bros. Discovery Inc. ("WBD") resigned from the WBD board of directors after the DOJ expressed concerns that their ties to both the WBD and Charter Communications Inc. ("Charter") boards violated Section 8 of the Clayton Act's prohibition of interlocking directorates—as Charter and WBD compete in providing "video distribution services to customers."[14] One of the directors at issue is a board member of Charter. The other director is a co-president of Advance Publications, Inc. ("Advance"), a private company that owns about 12% stake in Charter, and his brother, the other co-president of Advance, also serves on Charter's board.

03

CFIUS

Regulatory Updates to Modify CFIUS Procedures and Enhance Enforcement Authorities

In April 2024, the U.S. Department of the Treasury ("Treasury"), as chair of the Committee on Foreign Investment in the United States ("CFIUS"), issued a Notice of Proposed Rulemaking to modify certain CFIUS procedures and enhance the committee's penalty and enforcement authorities (the "Enforcement NPRM").[15]

The Enforcement NPRM would, among other things:

- expand the types of information CFIUS can require from parties to "non-notified transactions" (*i.e.*, transactions that were not notified to CFIUS);
- impose a deadline of three business days for parties to substantively respond to a CFIUS risk-mitigation proposal;
- enhance CFIUS's ability to impose civil monetary penalties for material misstatements and omissions by transaction parties;

- increase the maximum civil monetary penalty for certain violations from $250,000 to $5 million, and the penalty for other violations from the greater of $250,000 and the value of the transaction to the greater of $5 million and the value of the transaction; and
- expand CFIUS's ability to use its subpoena authority to obtain information relating to its national security reviews.

Comments on the Enforcement NPRM were due on May 15, 2024. Treasury has not yet issued a final rule.

The Enforcement NPRM is consistent with CFIUS's stated intentions to (1) periodically adjust its regulations to allow the committee to carry out its national security mission more efficiently and (2) devote additional resources and institutional focus to monitoring and enforcement. For transaction parties, the updates—if implemented as proposed—are likely to be seen as further evidence that the CFIUS process is becoming less predictable and more difficult to navigate.

MineOne Prohibition

In May 2024, President Biden issued an executive order prohibiting the acquisition by MineOne Cloud Computing Investment I L.P. ("MineOne"), a crypto mining group ultimately majority owned by Chinese nationals, of 12 acres in Cheyenne, Wyoming.[16] The property is located within one mile of Warren Air Force Base, a strategic base for intercontinental ballistic missiles and a key element of America's nuclear triad.[17]

MineOne acquired the land in 2022 in a transaction that was not filed with CFIUS at the time.[18] CFIUS's "non-notified" team investigated the transaction as a result of a public tip.[19] Following its investigation, CFIUS determined that it would not be possible to enter into a negotiated mitigation agreement with MineOne that would sufficiently address the identified national security risks in an effective, verifiable and monitorable manner and, as a result, referred the transaction to the President.[20]

The prohibition is notable for a number of reasons, including:

- it is the eighth presidential prohibition in CFIUS history (of course, many more transactions are voluntarily abandoned based on CFIUS concerns prior to reaching a formal presidential prohibition);
- it is the first presidential prohibition under the Biden administration;
- it is the first presidential prohibition to utilize CFIUS's real estate jurisdiction after the Foreign Investment Risk Review Modernization Act of 2018 (*i.e.*, the transaction involved the purchase of real estate, not an investment in a U.S. business);
- of the eight presidential prohibitions in CFIUS history, this is the fifth involving a divestiture, supporting the conventional wisdom that mitigating an identified national security risk is more difficult post-closing than pre-closing; and
- of the eight presidential prohibitions in CFIUS history, this is the seventh involving a national security threat that ultimately traces back to a Chinese acquiror or investor, demonstrating the difficulties faced by China-linked transactions.

Concurrently with the issuance of the executive order, Treasury issued a press release suggesting that MineOne may have been less than cooperative in the CFIUS process.[21] The press release noted, "In all CFIUS reviews, the parties' conduct can impact the Committee's assessment of what steps or actions are needed to resolve national security risks."[22]

Assistant Secretary of the Treasury Paul Rosen was also quoted as saying, "If CFIUS parties are unwilling or unable to fully address national security risks, CFIUS won't hesitate to exercise

the full scope of its authorities, including Presidential referrals, to address the risk."[23] Rosen added, "CFIUS expects complete, accurate, and timely information, particularly when serious national security issues are on the line."[24]

Notice of Proposed Rulemaking on Outbound Investment

In June 2024, Treasury issued a Notice of Proposed Rulemaking (the "Outbound NPRM") that sets forth proposed regulations to implement President Biden's August 2023 Executive Order addressing national security concerns raised by certain U.S. outbound investments.[25]

The Outbound NPRM is largely consistent with the Advance Notice of Proposed Rulemaking (the "ANPRM") issued by Treasury in August 2023 and discussed in Cravath's Quarterly M&A Review for Q3 2023.[26]

Specifically, the Outbound NPRM would maintain the basic framework proposed in the ANPRM, which consists of a program with two distinct parts: (1) certain outbound investment transactions will need to be notified to Treasury no later than 30 days following completion of the transaction; and (2) U.S. persons will be prohibited from engaging in certain outbound investment transactions. Violations will be subject to civil and criminal penalties, as well as nullification, voidance or forced divestment of the transaction in question.

The People's Republic of China (including the Special Administrative Region of Hong Kong and the Special Administrative Region of Macau, the "PRC") continues to be the focus of the outbound program, although certain investments in entities in other jurisdictions can be affected if such entities hold a significant interest in covered PRC companies.

Finally, the Outbound NPRM maintains the ANPRM's concentration on three categories of national security technologies and products: (1) semiconductors and microelectronics; (2) quantum information technologies; and (3) certain artificial intelligence systems. The Outbound NPRM provides additional detail (including technical parameters) regarding when engagement with these technologies and products may constitute a basis for an investment to fall within the outbound program.

The Outbound NPRM answers many questions raised by the ANPRM but also contains indications that the U.S. Government is continuing to deliberate certain aspects of the program. Although some details remain to be settled, it is clear the program will have far-reaching implications for U.S. persons that directly or indirectly invest, or are engaged in business, in the PRC, particularly as relating to semiconductors and microelectronics, quantum information technologies or artificial intelligence.

Comments on the Outbound NPRM may be submitted until August 4, 2024. After reviewing public comments, Treasury will develop final regulatory text to implement the program. The program will become effective sometime (likely 30 days) after the publication of the final rule.

04

Activism[27]

Observations regarding activist activity levels in H1 2024 include:

- Global activist activity in H1 2024 mostly maintained 2023's swift pace with ~150 new campaigns globally, representing a ~5% decrease from H1 2023.
- U.S. activist activity increased in H1 2024, representing the largest regional share of global activist activity at ~55% of all new campaigns. The ~80 new campaigns launched in the United States in H1 2024 represented a ~30% increase from H1 2023.

- Activist activity in Europe decreased in H1 2024 compared to H1 2023. The ~25 new campaigns launched in Europe in H1 2024 (~15% of all new campaigns globally) represented a ~30% decrease from H1 2023.
- Activist activity outside the United States and Europe decreased in H1 2024 compared to H1 2023. The ~45 new campaigns launched outside the United States and Europe in H1 2024 (~30% of all new campaigns globally) represented a ~30% decrease from H1 2023.

05

Tax

IRS Guidance on Spin-off Transactions

On May 1, 2024, the Internal Revenue Service ("IRS") released updated guidelines for tax-free spin-off and split-off transactions that reflect a significant narrowing of the IRS's private-letter ruling practice for those transactions. In particular, the guidelines restrict several common strategies used to monetize SpinCo stock, including pre-spin cash distributions ("boot purges") and debt-for-equity exchanges ("D4Es").

First, the IRS indicated that it will no longer issue rulings on D4Es using a direct issuance structure. The IRS is concerned that this structure, in which a parent entity borrows cash in connection with the spin-off and then uses SpinCo shares to repay the debt a few days later, too closely resembles a sale to qualify as a valid D4E. Although the IRS has signaled openness to rulings on an "intermediated" structure, in which a financial institution acquires existing parent debt (which is then satisfied by parent using SpinCo stock), even these intermediated structures will be scrutinized closely by the IRS.

Second, the IRS will now require that taxpayers choose upfront either to pursue a nontaxable D4E within 12 months or a taxable sale within five years (but not both) when submitting a request for a parent entity to retain any SpinCo stock following the spin-off. These retention-ruling requests will be subject to heightened scrutiny when certain factors indicate a continuing relationship between parent and SpinCo (many of which are present in most spin-off transactions).

Third, the new guidance will have significant consequences for parent companies seeking to use boot purge proceeds to repay funded debt with a short remaining maturity. As part of its guidance, the IRS has indicated that it will permit the repayment of funded debt using boot purge proceeds only if the debt was outstanding prior to announcement of the spin. Critically, pre-announcement debt that is subsequently refinanced after announcement will not satisfy this rule, which may significantly limit the universe of debt that can be validly repaid using proceeds of a boot purge.

These changes reflect major departures from the IRS's historic ruling practices for spin-offs. In addition, the IRS and Treasury plan to issue further substantive guidance generally aligned with these guidelines, which may have an even deeper impact on spin-off structuring (whether or not a ruling is sought).

Proposed Regulations on Stock Buyback Excise Tax

On April 12, 2024, the Treasury and IRS released proposed regulations providing guidance for the application of the 1% excise tax on public stock repurchases made after December 31, 2022 that clarify and formalize prior IRS guidance on the excise tax. In particular, the proposed regulations address how this excise tax will apply to both taxable and tax-free M&A transactions with cash consideration.

First, in the context of "take private" and other taxable transactions, the guidance establishes that the excise tax will generally apply to the extent

that the debt is funded by the target corporation with newly borrowed funds or cash in hand. As a result, any cash funded by the target will be viewed as a redemption and factored into the target's excise-tax calculation for the year, which is net of any other qualified issuances by the target during the same year.

Second, in the context of reorganizations and other tax-free exchanges, the excise tax generally will apply to the cash, but not the stock, consideration issued in the transaction. Notwithstanding this general rule, the regulations may allow for certain tax-free structures to avoid the excise tax, even though they are economically identical to those for which the excise tax applies. This asymmetry may be a factor that causes taxpayers to pursue these transaction structures over others.

Third, although the excise tax applies to publicly traded U.S. corporations, the proposed regulations indicate that it may also apply to certain repurchases by publicly traded foreign corporations with U.S. operations. As a technical matter, the applicable rule provides that, if a repurchase by a publicly traded foreign corporation is funded using cash sourced from a U.S. affiliate, such repurchase will be subject to the excise tax if done with a principal purpose of avoiding the excise tax. While this has been described as an anti-abuse rule, difficulties with interpreting the "principal purpose" standard may cause it to apply more broadly, including with respect to ordinary cash-pooling arrangements in which foreign corporations sweep cash from subsidiaries into a pool that is used for various purposes (including repurchases). As a result, foreign corporations and their affiliates that utilize these common cash-pooling arrangements are left with substantial uncertainty about their tax exposure.

While this guidance provides further clarity on the application of the excise tax, it remains uncertain exactly how broadly the tax may apply. Companies that participate in these types of common M&A deals should carefully consider the effect of the excise tax on the redemptions that may occur as part of their transactions.

06

Corporate Governance

ESG UPDATE

Exxon Lawsuit Against Activist Arjuna Capital Dismissed[28]

On June 17, 2024, the United States District Court for the Northern District of Texas dismissed as moot a lawsuit brought by Exxon against Arjuna Capital LLC ("Arjuna"). The suit had been closely watched both by companies and investors interested in the state of ESG-related shareholder proposals. In January 2024, Exxon filed a lawsuit aiming to prevent a climate proposal brought by Arjuna from going to a vote at its shareholder meeting in May. The proposal asked Exxon to accelerate the reduction of greenhouse gas emissions and to adopt Scope 3 targets to reduce emissions produced by users of its products. Exxon chose to file the suit rather than pursue the no-action process for Rule 14a-8 shareholder proposals administered by the staff of the Securities and Exchange Commission ("SEC"), which allows management to exclude shareholder proposals from the annual proxy with prior approval from the SEC.

In response, Arjuna withdrew the proposal and made an "unconditional and irrevocable pledge" not to file a similar shareholder proposal in the future. The Court found that by withdrawing its proposal and issuing its pledge, Arjuna eliminated any case or controversy between the parties, which required dismissal of the case without prejudice.

SEC UPDATES

SEC Stays Climate Rules

On April 4, 2024, the SEC ordered a stay of the final rules requiring climate-related disclosures for public companies ("Climate Rules").[29] The stay comes in response to numerous petitions filed in the United States Court of Appeals for the Eighth Circuit seeking a stay pending judicial review.

While the Climate Rules have been challenged by a number of states, companies and trade associations, the SEC maintains that the Climate Rules are consistent with applicable law and that it is within the SEC's authority to require the disclosure of information important to investors in making investment and voting decisions. Given the procedural complexities and large number of petitions for review, however, the SEC found that a stay of the Climate Rules met the statutory standard that "justice so required" the stay.

A full discussion of the Climate Rules can be found in the two Cravath client alerts on the subject.[30]

Judicial Scrutiny of SEC Rulemaking Intensifies[31]

On June 5, 2024, the United States Court of Appeals for the Fifth Circuit vacated the SEC's rules for private fund advisers (the "Private Fund Rules") adopted on August 23, 2023. The Private Fund Rules would have required fund managers to issue quarterly performance and fee reports, perform annual audits and prohibit preferential treatment for certain investors through the use of side letters.

In holding that the SEC exceeded its authority, the Court stated that the relevant sections of the Advisers Act on which the Private Fund Rules relied applied to retail customers and not to private fund investors. Additionally, the SEC's reliance on the antifraud authority in the Advisers Act failed because it did not define the specific fraud that it sought to prevent, nor did it provide a rational connection between such fraud and the Private Fund Rules. The challenge to the Private Fund Rules comes following the Fifth Circuit's order vacating the Share Repurchase Disclosure Modernization Rule in December 2023. The Fifth Circuit held that the "SEC acted arbitrarily and capriciously . . . when it failed to respond to petitioners' comments and failed to conduct a proper cost-benefit analysis", thereby violating the Administrative Procedure Act.

T+1 Settlement Effective as of May 28, 2024[32]

On February 15, 2023, the SEC adopted final rules to shorten the standard settlement cycle for most broker-dealer transactions in securities from two business days after the trade date (T+2) to one (T+1).[33] The compliance date for the final rules was May 28, 2024 and is now effective. The amended rules retain many of the same exceptions as the existing rules, including transactions involving exempted securities, government securities, municipal securities, commercial paper, bankers' acceptances, commercial bills and security-based swaps. However, for investors, this means that securities certificates may need to be delivered earlier or through different means, payment for securities may need to take place one day earlier and certain provisions of margin agreements may be impacted.

CYBERSECURITY UPDATES

CISA Proposes Federal Cyber Incident Reporting Requirements for Businesses Across 16 Sectors

On April 4, 2024, the U.S. Department of Homeland Security's Cybersecurity and Infrastructure Security Agency ("CISA") published a proposed rule (the "Proposed Rule")

titled The Cyber Incident Reporting for Critical Infrastructure Act ("CIRCIA") Reporting Requirements. The Proposed Rule outlines what will become the first broadly applicable federal cyber incident reporting requirements, and is the first significant regulatory step of CISA's implementation of CIRCIA since the law was enacted in March 2022.

The reporting requirements will apply to entities across 16 "critical infrastructure" sectors and will require "substantial" cyber incidents to be reported to CISA within 72 hours. Covered entities will also be required to report ransom payments to CISA within 24 hours. While CISA expects the final rule to be published in late 2025, companies—especially privately held companies in sectors that lack current reporting requirements—should assess whether the Proposed Rule applies to them and start to prepare accordingly.

A full discussion of the CISA Proposed Rule can be found in the Cravath client alert on the subject.[34]

SEC Clarifies Requirements for Material and Selective Cybersecurity Disclosures[35]

On May 21, 2024, Erik Gerding, the Director of the SEC's Division of Corporation Finance, issued a clarification (the "Clarification") on the requirements for material cybersecurity disclosures under Item 1.05 and Item 8.01 of Form 8-K.

The Clarification states that although Item 1.05 does not expressly prohibit voluntary filings, it could be confusing for investors if companies disclose under Item 1.05 either: (i) immaterial cybersecurity incidents or (ii) incidents for which a materiality determination has not yet been made. The Clarification suggested that, if all cybersecurity incidents are disclosed under Item 1.05, then there is a risk that investors would misperceive immaterial cybersecurity incidents as material, and vice versa. As such, the Clarification specified that Item 1.05 should be reserved for a cybersecurity incident determined by a company to be material and a Form 8-K voluntarily filed under Item 8.01 for other cybersecurity incidents.

On June 20, 2024, in a subsequent statement (the "Statement"), Director Gerding clarified the relationship between Item 1.05 and Regulation FD, which requires public disclosure of any material nonpublic information that has been selectively disclosed to securities market professionals or shareholders. The Statement outlined that nothing in Item 1.05 alters Regulation FD or prohibits a company from privately discussing a material cybersecurity incident with other parties or from providing information about the incident to such parties beyond what was included in an Item 1.05 Form 8-K and offered guidance on how public companies could privately share information regarding a material cybersecurity incident beyond what is disclosed in its Item 1.05 Form 8-K without implicating Regulation FD.

ACCOUNTING UPDATES

PCAOB Issues Proposal on Firm and Engagement Metrics[36]

On April 9, 2024, the Public Company Accounting Oversight Board ("PCAOB") voted to issue a proposal to require reporting of specified firm-level and engagement-level metrics in relation to public company audits (the "Proposal"). The Proposal would require firms that serve as lead auditor for at least one issuer that is an accelerated filer, including large accelerated filers, to report new firm-level metrics on a new Form FM. Additionally, the Proposal would require reporting of engagement-level metrics for audits of accelerated filers and large accelerated filers on a revised Form AP and allow, but not require,

limited narrative disclosures on both Form FM and Form AP to provide context and explanation for the required metrics.

The proposed metrics cover items such as:

- Experience of audit personnel;
- Industry experience of audit personnel;
- Audit hours and risk areas (engagement-level only); and
- Restatement history (firm-level only).

The Proposal aims to ensure reliable, consistent information in order to improve investors' ability to make informed decisions about investing their capital, ratifying the selection of auditors and voting for members of the board of directors (including audit committee members). Additionally, the Proposal aims to improve audit committees' ability to choose among and monitor the performance of auditors.

PCAOB Adopts New Risk-Based Quality Control Standard

On May 13, 2024, the PCAOB adopted a new standard designed to encourage registered public accounting firms to significantly improve their quality control ("QC") systems. The new standard would require all PCAOB-registered firms to identify their specific risks and design a QC system that includes policies and procedures to guard against those risks. Specifically, all PCAOB-registered firms would be required to design a QC system that complies with the new standard and annually evaluate their QC system and report the results of their evaluation to the PCAOB.

1 All data regarding M&A activity is from Refinitiv unless otherwise indicated. Deal values and volume may vary across our newsletters due to continuous updates to the M&A activity sources.

2 88 A.3d 635, 645 (Del. 2014).

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5 No. 2022-1001-KSJM (Del. Ch. Feb. 29, 2024).

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7 Delaware General Assembly, An Act to Amend Title 8 of the Delaware Code Relating to the General Corporation Law, S.B. 313, 84:309, https://legis.delaware.gov/BillDetail/141480.

8 Press Release, *FTC Moves to Block Tapestry's Acquisition of Capri*, FTC (April 22, 2024), https://www.ftc.gov/news-events/news/press-releases/2024/04/ftc-moves-block-tapestrys-acquisition-capri.

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10 Press Release, *FTC Order Bans Former Pioneer CEO from Exxon Board Seat in Exxon-Pioneer Deal*, FTC (May 2, 2024), https://www.ftc.gov/news-events/news/press-releases/2024/05/ftc-order-bans-former-pioneer-ceo-exxon-board-seat-exxon-pioneer-deal.

11 Press Release, *ExxonMobil Completes Acquisition of Pioneer Natural Resources*, ExxonMobil (May 3, 2024), https://corporate.exxonmobil.com/news/news-releases/2024/0503 _ exxonmobil-completes-acquisition-of-pioneer-natural-resources.

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19 *Id.*

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24 *Id.*

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Cravath, Swaine & Moore LLP

NEW YORK

Two Manhattan West
375 Ninth Avenue
New York, NY 10001
T+1-212-474-1000
F+1-212-474-3700

LONDON

CityPoint
One Ropemaker Street
London EC2Y 9HR
T+44-20-7453-1000
F+44-20-7860-1150

WASHINGTON, D.C.

1601 K Street NW
Washington, D.C. 20006-1682
T+1-202-869-7700
F+1-202-869-7600