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Recent Changes to Statutory & Regulatory Frameworks in the Context of M&A Deals

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Agenda

- Introductions
- Recent Updates to DOJ's Evaluation of Corporate Compliance Programs
  - Impacts on Companies and Their Compliance Programs
- Delaware General Corporation Law Update
  - Review of Recent Del. Chancery Decisions
  - Impacts on M&A Activities
- Q&A

Today's Presenters

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Recent Updates to DOJ's Evaluation of Corporate Compliance Programs

Evaluation of Corporate Compliance Programs: Background

- ECCP History
  - 2017 framework for assessing compliance programs
- DOJ Enforcement
  - Justice Manual: "Principles of Federal Prosecution of Business Organizations"
  - United States Sentencing Guidelines
  - Criminal Division policies
- Assisting prosecutors in "making informed decisions regarding effectiveness of compliance programs," including when it comes to:
  - Form of resolution
  - Monetary penalty
  - Go-forward compliance obligations

Evaluation of Corporate Compliance Programs: Framework & Priorities

- Three basic questions:
  - Is the corporation's compliance program well designed?
    - Risk assessment, policies and procedures, training and communications, confidential reporting structure and investigation process, third party management, mergers & acquisitions
  - Is the program being applied earnestly and in good faith? In other words, is the program adequately resourced and empowered to function effectively?
    - Commitment by senior and middle management, autonomy and resources, compensation structures and consequence management
  - Does the corporation's compliance program work in practice?
    - Continuous improvement, periodic testing and review, investigation of misconduct, analysis and remediation of any underlying misconduct

Evaluation of Corporate Compliance Programs: Focus of Recent Update

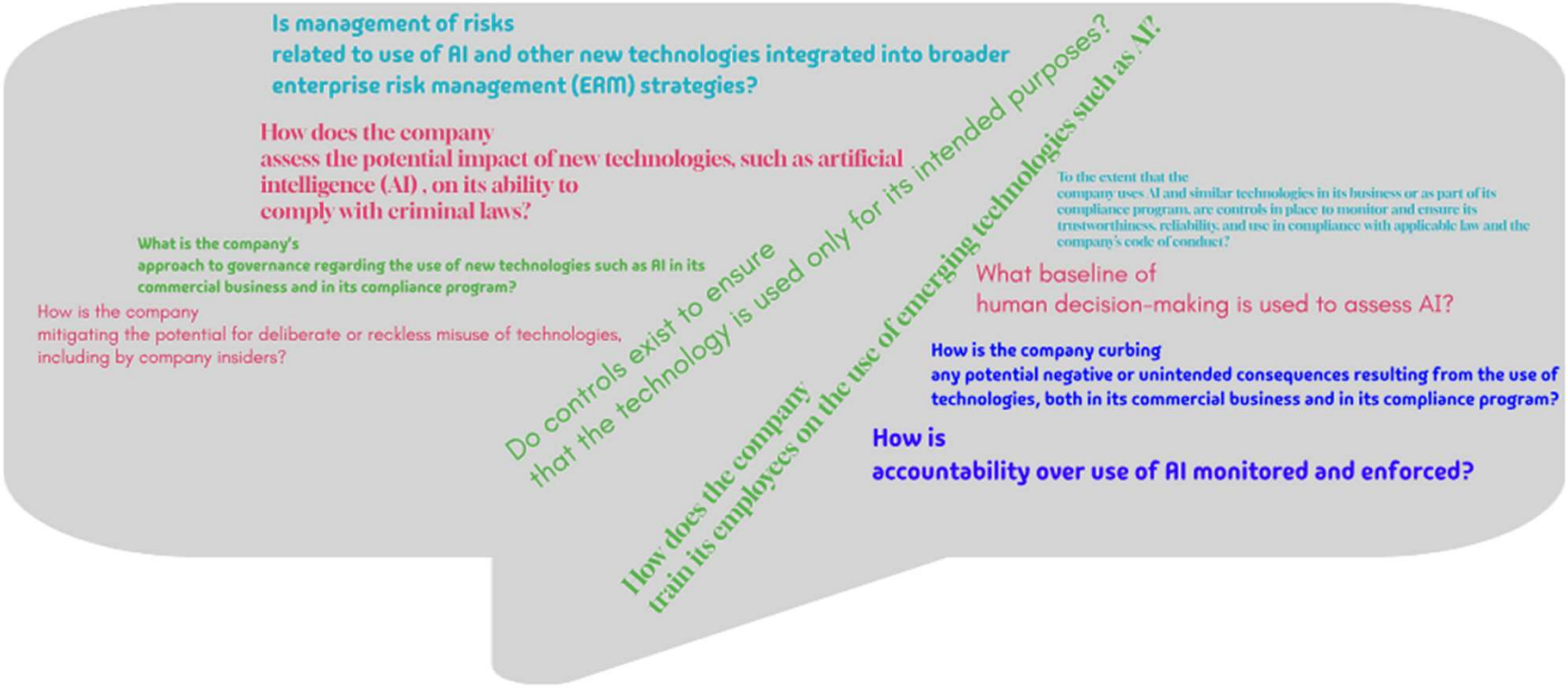
- September 23, 2024 Update to ECCP
- Key themes in update:
  - Technology
  - Proactively Improving Compliance Programs
  - Anti-Retaliation
  - Training
  - Mergers & Acquisitions

ECCP Priorities in Update: Technology

- Prosecutors will now pay close attention to the technology—especially new and emerging technologies—that a Company is using to conduct its business
- Companies need to be mindful about:
  - Conducting an appropriate risk assessment
  - Taking appropriate steps to mitigate any risk associated with use
- Resource allocation for compliance is important
  - The guidance does not just apply to core business functions
  - Companies must ensure compliance programs make appropriate use of data-driven technology

ECCP Priorities in Update: Technology (cont'd)

- Are you asking the right questions about emerging technologies, in particular, **AI**?



ECCP Priorities in Update: Proactively Improving Compliance Programs

- The Department is signaling a clear message: compliance programs are not static, they need to evolve with the business, industry, and times
  - Prosecutors will consider whether the company has engaged in meaningful efforts to proactively review its compliance program and ensure that it does not become stale
- Recent guidance suggests companies must:
  - Assess compliance concerns occurring not only within themselves, but also within companies in comparable industries or geographies, so they may identify lessons learned and areas for improvement
  - Leverage data analytics tools to make its compliance operations more efficient and to measure the effectiveness of its compliance program (*see* Point 1, re Technology)

ECCP Priorities in Update: Anti-Retaliation

- Recent regulatory enforcement trends (by the DOJ, the SEC, and others) suggest an emphasis on ensuring companies create a culture that *encourages*, as opposed to *chills*, employee reporting of compliance issues
  - Exchange Act Rule 21F-17
- Thoughts to consider:
  - Does the company have an anti-retaliation policy?
  - Does the company train employees on both internal anti-retaliation policies and external anti-retaliation and whistleblower protection laws?
  - Does the company train employees on internal reporting systems as well as external whistleblower programs and regulatory regimes?

ECCP Priorities in Update: Training

- Back to basics: a company's compliance program is only effective if it is known to, and understood by, employees
  - The DOJ has made clear it will consider how the company tracks employee engagement with trainings and how the company measures what employees learned from the trainings
- A company training program should:
  - Encompass key company policies
  - Change with the times, just like the company's compliance program
    - Employees need refreshers; one-and-done does not cut it
  - Monitor employee attendance, engagement, and synthesis
    - Consider live trainings as a means of maximizing engagement
    - Consider testing before and after, or analyzing reporting trends, following trainings

ECCP Priorities in Update: Mergers & Acquisitions

- Merger and acquisition due diligence (both pre- and post-integration) has always been a focus for regulators
- In the context of M&A, a well-designed compliance program must include:
  - Comprehensive due diligence of any acquisition targets
  - A process for timely and orderly integration of the acquired entity into the compliance program structures and internal controls
  - A process connecting due diligence to implementation
  - An appropriately implemented compliance program post-transaction
- The DOJ's perspective: the extent to which a company subjects a target to appropriate scrutiny and ferrets out compliance problems is a core indicator of whether its compliance program is functioning as intended

ECCP Priorities in Update: Mergers & Acquisitions (cont'd)

- In its recent update, the DOJ has doubled-down on several key priorities in the context of mergers and acquisitions
- Integration in the M&A Process:
  - Does the company account for migrating or combining critical enterprise resource planning systems as part of the integration process?
  - To what extent did compliance and risk management functions play a role in designing and executing the integration strategy?
- Post-Transaction Compliance Program:
  - Does the company have a process in place to ensure appropriate compliance oversight of the new business?
  - How is the new business incorporated into the company's risk assessment activities?

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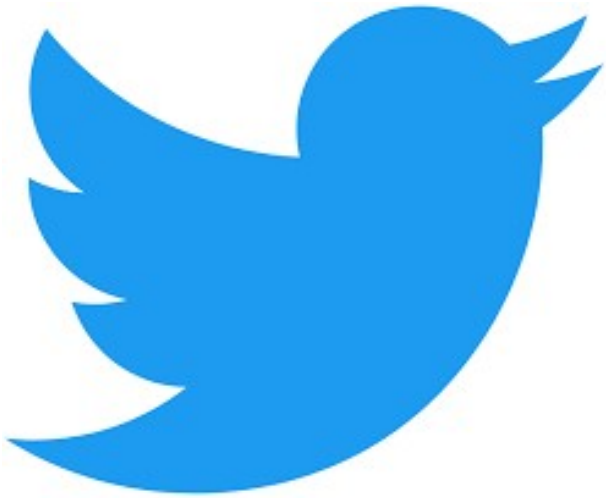
Delaware General Corporation Law Update

Delaware's "Board-Centric" Model of Corporate Governance

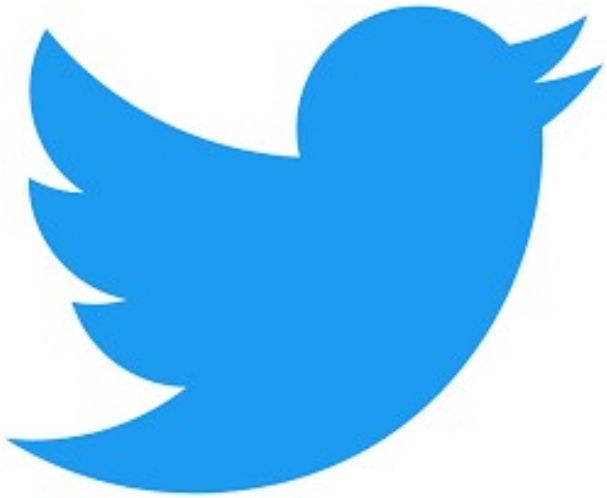
- Section 141(a) of the Delaware General Corporation Law:
  - "The business and affairs of every corporation organized under this chapter shall be managed by or under the direction of a board of directors, except as may be otherwise provided in this chapter or in its certificate of incorporation. If any such provision is made in the certificate of incorporation, the powers and duties conferred or imposed upon the board of directors by this chapter shall be exercised or performed to such extent and by such person or persons as shall be provided in the certificate of incorporation." (emphasis added)
- Section 141(c) of the Delaware General Corporation Law:
  - "The board of directors may designate 1 or more committees, each committee to consist of 1 or more of the directors of the corporation."

Recent Court of Chancery Decisions: Crispo v. Musk (Oct. 2023)



- Question: If a party (usually the buyer) refuses to close the transaction, can the jilted company (usually the target) obtain "benefit-of-the-bargain" damages, including the lost premium that would have gone to stockholders?
- Decision: Only stockholders who are third-party beneficiaries of the agreement, ***not*** the corporation, would be entitled to such damages.
- Case arose in context of Musk's acquisition of Twitter; stockholder sought specific performance and damages, plus attorneys' fees after the deal ultimately closed.

Recent Court of Chancery Decisions: Crispo v. Musk (Oct. 2023)



- Court rejected attorneys' fees claim, holding that the stockholder's original claims were not meritorious when filed.
  - To sue for breach of the merger agreement, Plaintiff needed to be a third-party beneficiary; agreement provided for such status only in limited, not-relevant circumstances.
  - Only Twitter, as the party to the agreement, had the right to seek specific performance.
- Court also noted that "benefit-of-the bargain," lost premium damages would not be available to the target corporation.
  - In a merger involving conversion of stock into the right to be paid cash, stockholders, not the corporation, are paid the deal consideration.
- Practitioners generally had assumed that target companies could seek such damages under DE law in the event of a busted deal.

Recent Court of Chancery Decisions: Moelis (February 2024)

- Question: What governance arrangements are consistent with Delaware's Board-centric governance model as codified in the DGCL?
- Company entered into agreement purporting to give founder/controlling stockholder governance-related rights in preparation for IPO, including:
  - Founder's consent before taking 18 different categories of action
  - Board size not to exceed 11 directors
  - Founder nomination rights for a majority of the Board & right to fill vacancies in those seats with new founder designees
  - Board to recommend that the Company's stockholders vote in favor of the founder's designees
  - Company to use reasonable efforts for founder designees to be elected & continue to serve
  - Board to include a certain number of founder's designees on each committee

Recent Court of Chancery Decisions: Moelis (February 2024), cont'd

- Court determined that most of those rights (consent rights, Board size requirement, obligation to recommend founder's nominees and fill vacancies with such nominees, and Board committee requirement) violated the DGCL.
- Stockholder agreement was an internal governance arrangement, but under Section 141(a) of the DGCL – the "bedrock" of DE law and a "cardinal precept" — the business and affairs of the corporation must be managed by or under the direction of the Board unless provided otherwise in the certificate of incorporation or in the DGCL.
- The improper provisions amounted to an improper constraint on Board authority in violation of Section 141(a) and interfered with the Board's authority to use its best judgment on management matters and policy.
- Court noted there may have been other structural pathways to design a corporate structure that worked similarly to the arrangement in question, such as by incorporating certain of the stockholder rights into the certificate of incorporation.

Recent Court of Chancery Decisions: Sjunde AP-fonden v. Activision (Feb. 2024)

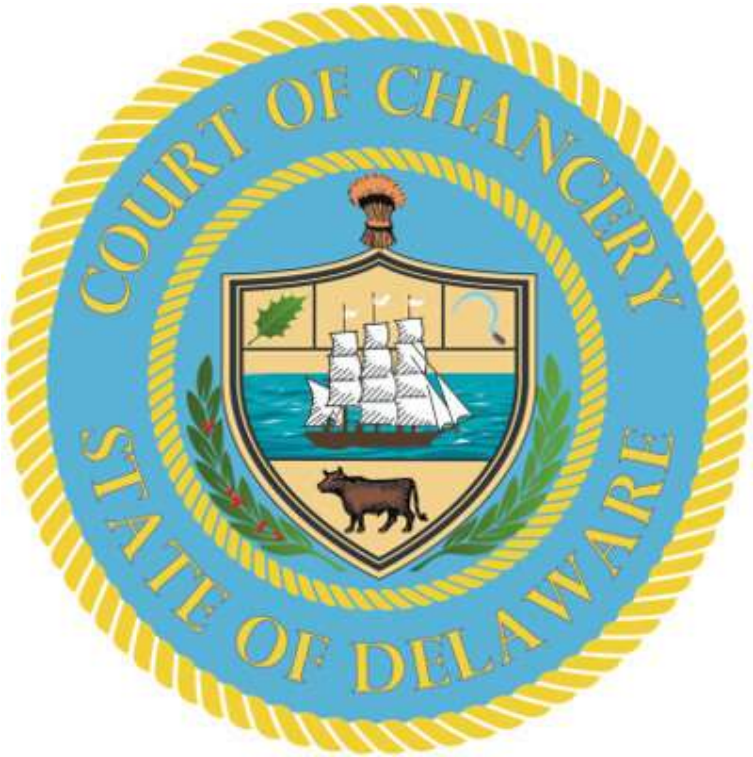
- Decision concerned Microsoft's acquisition of Activision Blizzard; stockholder had filed claims arguing that the Board did not comply with the technical requirements of Section 251(b) and (c) of the DGCL.
- Court called into question common practices for target companies in a merger.
  - Insufficient for target Board to be presented with incomplete, "near-final" version of the merger agreement lacking purchase price, company disclosure letter, certificate of incorporation of the surviving corporation, and all finalized key terms.
  - Realities of negotiating a complex transaction could not supersede DGCL: "When market practice exceeds the generous bounds of private ordering afforded by the DGCL, then market practice needs to check itself."

Recent Court of Chancery Decisions: Sjunde AP-fonden v. Activision (Feb. 2024)

- Insufficient for notice of the stockholders' meeting to include an agenda item for a stockholder vote, plus a proxy statement and a copy of the merger agreement.
- Notice required to include a copy of the certificate of incorporation of the surviving company, as well as a summary of the merger agreement, notwithstanding that the proxy statement annexed the merger agreement.

Reaction to Crispo, Moelis, and Activision

- Decisions were surprising, had important implications for corporate practitioners, and gave rise to significant discussion; viewed as disruptive to market practice and expectations.
- Uncertainty concerning stockholder rights, transaction approval, and lost premium damages led to concerns that Delaware had become a more unpredictable, and potentially problematic, state of incorporation.
- Council of the Corporation Law Section of the DE State Bar Association acted quickly: proposed amendments released at the end of March 2024.



Resulting Amendments to the DGCL (August 2024)

- The amendments, which were then introduced to the DE General Assembly for approval, were adopted on August 1, 2024.
- Amendments apply both prospectively and retrospectively.
- Approval process generated more publicity and controversy than is typical in Delaware.
- In response to *Moelis* (Sections 122(18) and 261(a)(2)):
  - Companies and stockholders can enter into stockholder agreements conferring, among other things, governance rights upon stockholders and obligations upon the corporation.
  - Outside of the certificate of incorporation, a corporation can enter into agreements with current or prospective stockholders giving stockholders consent rights or specifying that the corporation, stockholders, or directors will take certain actions or refrain from taking certain actions.

Resulting Amendments to the DGCL (August 2024), cont'd

- In response to *Crispo* (Section 261(a)(1)):
  - Parties to a merger agreement may provide for penalties or consequences for a breach of the merger agreement and to allow the target corporation to obtain an award of damages based on the loss of premium payable to stockholders should the deal fall apart.
- In response to *Activision* (Sections 147, 268(a) and (b), and 232(g)):
  - Documents requiring board approval under the DGCL (such as merger agreements or charter amendments) may be approved by the Board in "substantially" final form, subject to a new ratification process by which a board can finally approve such documents before certain filings in respect of such documents are filed and become effective with the State of Delaware.
  - Disclosure schedules are not part of the merger agreement that the board and stockholders must approve.
  - Merger agreement need not include a copy of the as-amended charter of the surviving corporation in deals where stockholders will not receive stock in the surviving corporation.
  - Documents enclosed with or annexed to notices delivered to stockholders are deemed part of the notice.
  - Ratification process for approval of an instrument such as a merger agreement following a prior approval that might have been incomplete.

Implications and Considerations from DGCL Amendments

- Amendments concerning external governance arrangements and those relating to Board approval of merger and similar agreements largely codify market practice.
  - Long-standing expectation that a DE corporation can enter into agreements with its stockholders, both to grant corporate governance rights and limit the corporation from taking action without approval.
    - Potentially greater scrutiny on application of fiduciary duties in entering stockholder agreements.
  - Long-standing market practice regarding Board approval of merger agreements and stockholder notices.
    - Amendments are drafted broadly enough that they should extend beyond merger agreements to other types of instruments (such as charter amendments); may provide relief in other transactional settings.
  - Not expected to have a significant impact on Delaware practice.

Implications and Considerations from DGCL Amendments (cont'd)

- While amendments concerning penalties or consequences for a busted deal also generally align the DGCL with the market's expectation that target companies could seek lost premium damages, they are still likely to have an impact on merger negotiations and allocation of risk in the event of (an acquirer's) breach.
- Efforts to add anti-*Crispo* language into merger agreements where the target can get it, including both a lost premium damages provision and a provision giving the target company's stockholders third-party beneficiary rights.
- Anticipate greater scrutiny on merger agreement provisions intended to address these issues.

Q&A

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