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KEY DEVELOPMENTS IN SECURITIES LITIGATION AND ENFORCEMENT

AI, Cybersecurity, and Governance

September 10, 2024

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ACC Greater Philadelphia

Presenters:

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- Richard A. Levan

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Agenda

- Securities class action and enforcement trends generally.
- Cases involving allegations related to the use of or statements about AI.
- Cases involving Cyber breaches and the impact of the recent *SolarWinds* decision.
- The impact of the Supreme Court's *Jarkesy* decision limiting the use of ALJ's in enforcement proceedings.
- Cases to watch regarding pleading requirements and risk factor disclosures.
- Recent changes to Delaware Corporate law and the impact on board and stockholder governance.

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Securities Litigation and Enforcement Activity Overview

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Securities Class Action Trends

- 112 new federal securities class action suits filed in the first half of 2024.
- 106 were standard cases containing alleged violations of Rule 10b-5, Section 11, and/or Section 12.
- 54% of filings were against companies in the electronic technology and technology services and the health technology and services sectors.
- The Ninth Circuit is the most active, with almost 37% of filings. The Second Circuit accounts for 21% of filings, and the Third Circuit has 11%.
- 38% of cases alleged missed earnings guidance.

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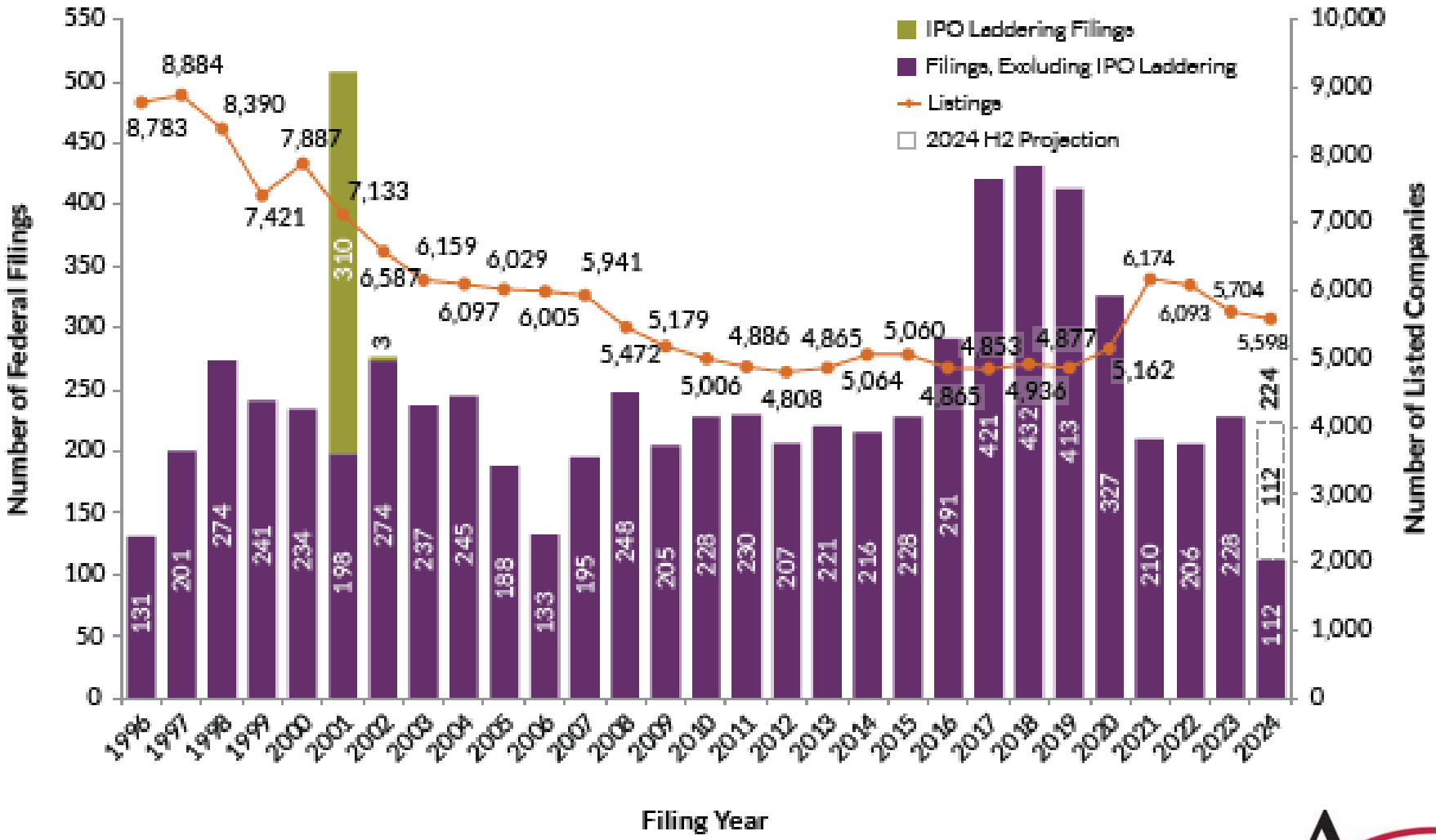
* NERA, Recent Trends in Securities Class Action Litigation: 2024 H1 Update

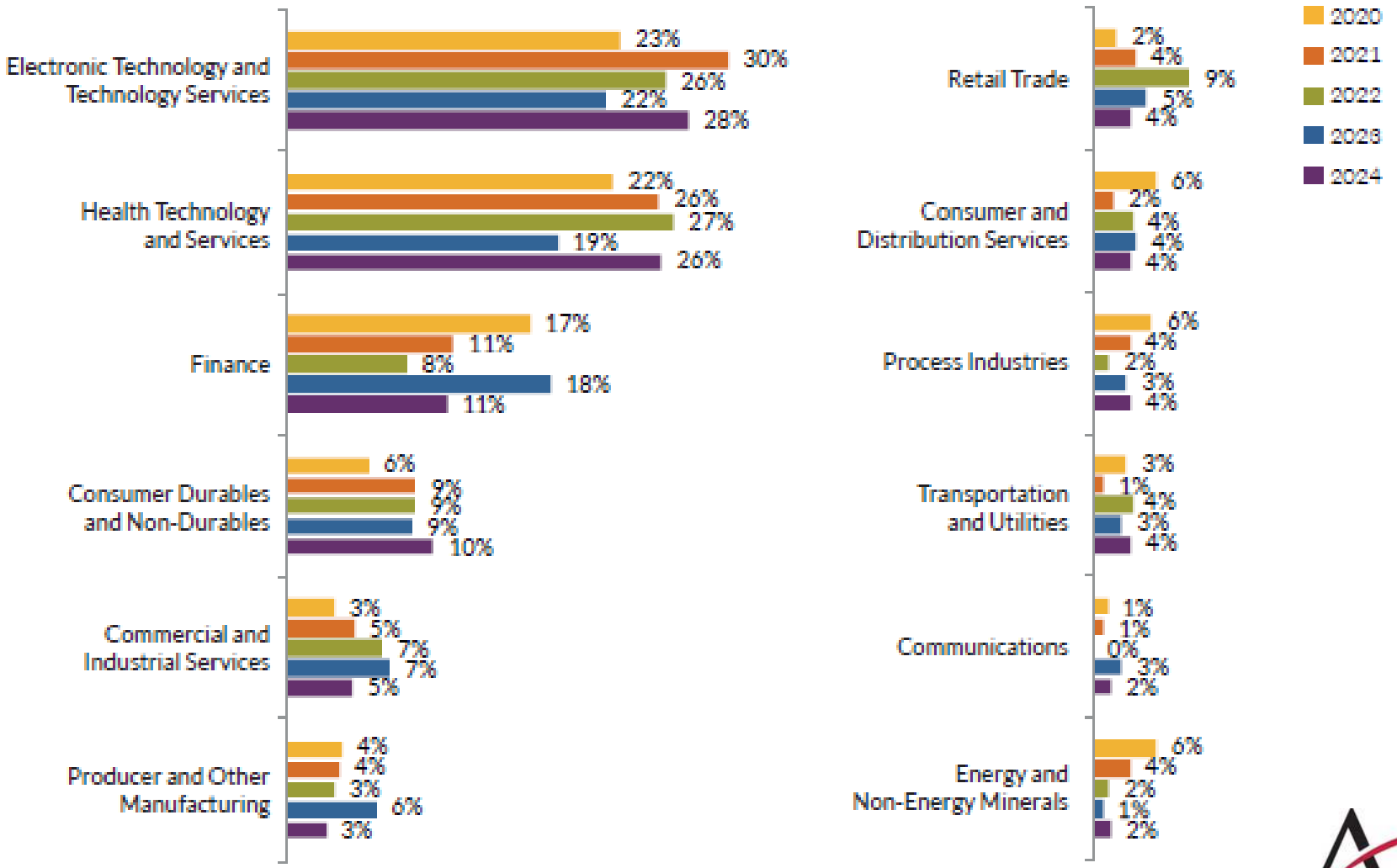
Figure 1. Federal Filings and Number of Companies Listed in the United States
January 1996–June 2024



Note: Listed companies include those listed on the NYSE and Nasdaq. Listings data obtained from World Federation of Exchanges (WFE). The 2024 listings data are as of May 2024.

* NERA, Recent Trends in Securities Class Action Litigation: 2024 H1 Update

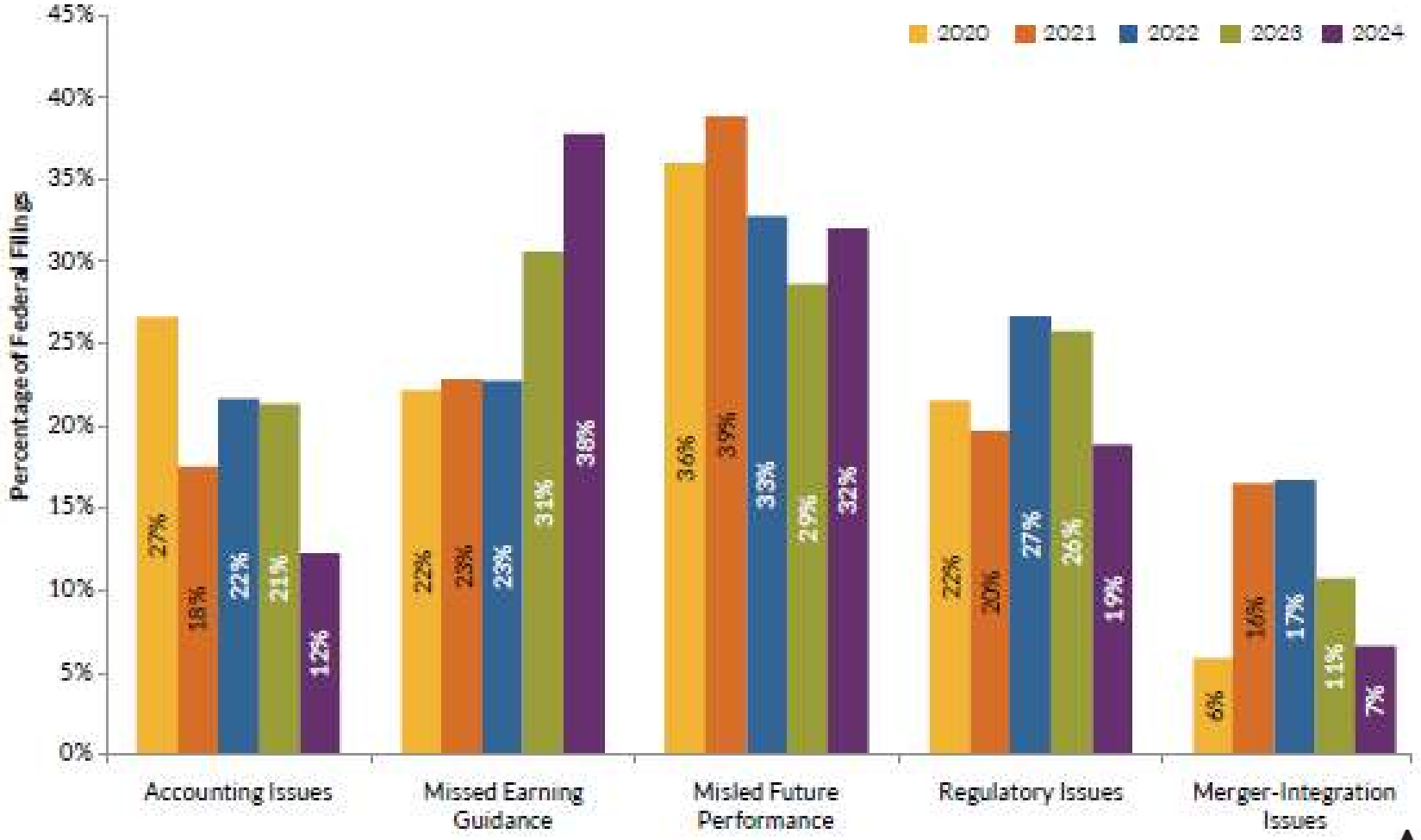
Figure 3. Percentage of Filings by Sector and Year
Excludes Merger Objections and Crypto Unregistered Securities
January 2020–June 2024



Note: This analysis is based on the FactSet Research Systems, Inc. economic sector classification. Some of the FactSet economic sectors are combined for presentation.

* NERA, Recent Trends in Securities Class Action Litigation: 2024 H1 Update

Figure 5. **Allegations**
Shareholder Class Actions with Alleged Violations of Rule 10b-5, Section 11, and/or Section 12
January 2020–June 2024



* NERA, Recent Trends in Securities Class Action Litigation: 2024 H1 Update

SEC Enforcement Trends

- Reporting year ends September 30, so expect a lot of activity in September.
- 2024 has witnessed some significant developments.
  - SEC prevailed at trial in its first-ever “shadow trading” case.
  - The private funds rule was vacated by the 5th Circuit.
  - The U.S. Supreme Court curtailed the use of administrative law proceedings.
  - The SDNY rejected the SEC’s attempt to bring “Internal Accounting Controls” charges.
  - The SEC engaged in three separate sweeps that resulted in charges against 32 firms related to recordkeeping and off-channel communications.
  - The SEC’s Final Climate Change Rule is under attack in the 8th Circuit (briefing closed 9/3/24).

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SEC Enforcement Trends (con't)

- **The SEC secured a victory in the *Panuwat* "Shadow Trading" case.**
  - The SEC alleged that Panuwat's trading in a competitor based on inside information that he received concerning the proposed acquisition of his company constituted trading on the basis of material non-public information.
  - None of the inside information he had concerned the company he traded in.
  - In denying his motion for summary judgment, the Court held that a jury could find that information was material on the basis that the competitor had a "market connection" to his company.
  - On April 5, 2024, a federal jury in the Northern District of California found defendant Matthew Panuwat liable for insider trading

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SEC Enforcement Trends (con't)

- **The SEC suffered a loss when its private funds rule was vacated.**
  - On June 5, 2024, the Fifth Circuit in *National Ass'n of Private Fund Mgrs v. SEC*, No. 23-60471, vacated the proposed private funds rule as exceeding the SEC's statutory authority.
  - The proposed rule sought to:
    - Prohibit preferential treatment or "side letters";
    - Restrict certain activities, including charging or allocating fees and expenses to private funds;
    - Require quarterly statements to investors about compensation, fees, expenses and performance;
    - Require transparency in adviser-led secondary transactions;
    - Enhance recordkeeping and require additional documentation of annual compliance policy review.

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SEC Enforcement Trends (con't)

- Section 211(h) provides the SEC with the power to prescribe certain rules regarding "any investment advisers that the [SEC] deems contrary to the protection of investors."
- The Fifth Circuit held that Section 211(h) has "nothing to do with private funds", applies only to retail customers, and that Congress "clearly chose not to impose the same [restrictions] on private funds."
- Section 206(4) allows the SEC to "define and prescribe means reasonably designed to prevent" fraudulent or deceptive practices regarding any investment adviser.
- The Fifth Circuit described the SEC's argument for fraud prevention under the Final Rule as nothing more than "vague assertions" that did not specify how the Final Rule would prevent fraud. It also found no "close nexus" between the Final Rule and the statutory goals of Section 206(4), stating that "a failure to disclose cannot be deceptive without a duty to disclose," and that no such duty exists.

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SEC Enforcement Trends (con't)

- **The SEC's use of Administrative Law Proceedings was curtailed. (Jarkesy v. SEC)**
  - In 2013, the SEC brought an in-house action against George Jarkesy and his firm, Patriot28, LLC alleging violations of the antifraud provisions of the federal securities laws.
  - An ALJ found Jarkesy liable for securities fraud and ordered him to pay $300,000 in civil monetary penalties, among other sanctions.
  - Jarkesy appealed to the Fifth Circuit, which reversed and remanded, finding that the SEC's decision to adjudicate the matter in-house (rather than in federal court) violated Jarkesy's Seventh Amendment right to a jury trial.
  - The Supreme Court took up the case and affirmed the Fifth Circuit, reasoning that the Seventh Amendment guaranteed the right to a jury trial where the government sought to impose a civil penalty because the fraud-based charges were "private" in nature, not public.

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SEC Enforcement Trends (con't)

- **Jarkesy's Impact**
  - The Supreme Court reasoned that the "public rights" exception to the Seventh Amendment did not apply to Jarkesy's case because the SEC's suit targeted "the same basic conduct as common law fraud," which amounts to a "matter[] of private rather than public right."
    - The "public rights" exception allows Congress to assign matters considered "legal in nature" for decision to an agency without a jury. Examples include revenue collection, certain customs and immigration laws, or relations with Native American tribes.
  - The Jarkesy decision raises questions about whether other agencies can institute in-house proceedings to enforce civil penalties. This is particularly noteworthy because some agencies, such as the Occupational Safety and Health Review Commission, are only statutorily authorized to pursue enforcement through in-house proceedings.
  - The SEC must now litigate all civil penalty cases in federal court.
  - The SEC was, however, already litigating most/all civil penalty cases in court.
  - Federal court actions are longer, more labor intensive, and procedurally more complicated than administrative proceedings.

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SEC Enforcement Trends (con't)

- **Trial Court rejects SEC attempt to bring "Internal Accounting Controls" charges (SolarWinds)**
  - On Oct. 30, 2023, the SEC filed a high-profile lawsuit asserting fraud and internal controls charges against software company SolarWinds Corp. and its chief information security officer, Timothy G. Brown, in connection with a massive 2020 breach of SolarWinds' network monitoring software system, Orion.
  - The SEC has been pursuing cybersecurity investigations and enforcement actions aggressively against issuers on two primary theories: 1) the company made material misrepresentations in its disclosures about cybersecurity risks and a material cybersecurity incident; or 2) the company maintained deficient disclosure and/or internal controls to ensure material cybersecurity risks are timely and accurately assessed and disclosed by appropriate decision-makers.

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SEC Enforcement Trends (con't)

- On July 18, 2024, the trial judge dismissed most of the case that was based on internal and disclosure controls.
- The court's rejection of the SEC's "internal accounting controls" claim under Section 13(b)(2)B) of the Exchange Act has significant implications for public companies beyond the cybersecurity context.
- In recent years, the SEC has expanded its assertion of enforcement authority under the statute by reading the term "internal accounting controls" to include the entirety of companies' risk management and control functions, not limited to accounting controls.
- The SEC has brought enforcement actions under the provision based, for example, on criticisms of companies' stock buyback policies and the selection of an airline's domestic flight route.

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SEC Enforcement Trends (con't)

- The SEC's theory in this case—that a company may be found to have violated the statute wherever any "asset" in its possession was "accessed" by an unauthorized party—would have allowed the SEC to assert a violation of the Exchange Act whenever a company experienced a cybersecurity breach, among other circumstances.
- Two SEC Commissioners have repeatedly dissented on the basis that the SEC's reading of its authority under the provision has exceeded the power granted to it by Congress in the statute, but this is the first court opinion to address the SEC's interpretation of its authority, in regard to cyber events.
- While the SEC may continue to seek to bring non-accounting-related charges under the provision, the court's opinion is likely to have a significant effect on the SEC's efforts to do so, and on companies' assessment of the SEC's ability to succeed in its claims.

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SEC Enforcement Trends (con't)

- **SEC performed three separate sweeps in 2024 related to recordkeeping and off-channel communications.**
  - In February, the SEC settled charges against 5 broker-dealers, 7 registered broker-dealers and investment advisers, and 4 affiliated investment advisers for failing to maintain and preserve electronic communications
  - In August, the SEC announced settled charges against 26 broker-dealers, investment advisers, and dually-registered broker-dealers and investment advisers, recordkeeping and off-channel communications lapses.
  - Last week the SEC entered into settlements with 6 separate ratings agencies over the same conduct.

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AI Focused Securities Litigation and Enforcement

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Securities Litigation Filings - AI

- Numerous securities class actions involving statements about AI have been filed, with the first half of 2024 seeing the most activity.
- The common allegations in many of these cases assert that companies have overstated the use or effectiveness of AI in their own or their clients' businesses.
  - *Jaeger v. Zillow Group Inc. et al., 21-cv-01551 (W.D. Wash.) (Filed 11/15/21)*
  - *Crain v. Upstart Holdings, Inc. et al, No. 2:22-cv-02935 (S.D. Ohio)(Filed 7/26/22)*
  - *D'Agostino v. Innodata Inc.*, Case No. 2:24-cv-00971 (D.N.J.) (Filed 2/21/24)
  - *Raby v. Evolv Technologies Holdings, Inc.*, Case No. 1:24-cv-10761 (D. Mass) (Filed 3/25/24)
  - *Steiner v. UiPath, Inc.*, Case No. 1:24-cv-04702 (S.D.N.Y.) (Filed 6/20/24)
  - *Pouladian v. Vicor Corp.*, Case No. 3:24-cv-04196 (N.D. Cal) (Filed 7/11/24)
  - *Hoare v. Oddity Tech, Ltd.*, Case No. 1:24-cv-05037 (E.D.N.Y) (Filed 7/19/24)

Jaeger v. Zillow Group Inc. (W.D. Wash.) (11/15/21)

- Plaintiffs alleged that Zillow misrepresented the abilities of its Zillow Offers tool, which used algorithms and technology to buy and resell homes quickly.
- Zillow's statements touted that Zillow Offers' success and ability to react more quickly to market conditions was because of its use of a neutral network model that included "artificial intelligence systems that imitate how the human brain works. They are able to map hundreds of millions of data points efficiently."
- The Complaint alleges that the tool was unable to accurately forecast home prices, resulting in significant losses and a wind-down of the business.
- The shareholder class asserted that Zillow violated Section 10(b), Rule 10b-5 thereunder, and Section 20(a).

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Crain v. Upstart Holdings, Inc. (S.D. Ohio) (7/26/22)

- Plaintiffs alleged that Upstart made misrepresentations regarding its "cloud-based AI lending platform" by misleading investors concerning the "significant advantage" of their AI model over traditional FICO-based underwriting models, especially with how it performed in the face of macroeconomic changes.
- The Complaint claims that in reality Upstart's AI model was unable to adequately assess credit risk and did not work effectively or quickly to respond to economic changes.
- Complaint asserts violations of Section 10(b) of the Exchange Act, Rule 10b-5 thereunder, as well as Section 20(a).
- Motion to dismiss was denied.

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D'Agostino v. Innodata Inc., (D.N.J.) (2/21/24)

- Plaintiffs alleged that the defendants lacked a reasonable basis for their positive statements about Innodata's business and financial outlook.
- Asserts violations of Sections 10(b) of the Exchange Action, Rule 10b-5 thereunder, as well as Section 20(a).
- Claim defendants made false and misleading statements and/or failed to disclose:
  - that defendant did not have "viable AI technology";
  - that the AI platform was "a rudimentary software developed by just a handful of employees";
  - that it was not going to utilize AI to any significant degree for new Silicon Valley contracts; and
  - it was not effectively investing in research and development for AI.

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Raby v. Evolv Tech. Holdings, Inc., (D. Mass) (3/25/24)

- Plaintiffs allege the company overstated the effectiveness of its AI-based weapons detection products.
- Evolv had stated that its detectors use “advanced sensors, artificial intelligence software and cloud services” to detect guns, explosives and knives while ignoring harmless items like phones and keys.
- Plaintiffs claim that beginning in November 2022, a series of news articles and Evolv SEC filings revealed that the company and the individual defendants made false representations about its technology's ability to locate weapons.
- The Complaint asserts violations of Section 10(b), Rule 10b-5 thereunder, and Section 20(a).

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Steiner v. UiPath, Inc., (S.D.N.Y.) (Filed 6/20/24)

- Plaintiffs alleged that UiPath lied about the success of its turnaround strategy, fueled in part by its AI-powered Business Automation Platform, by claiming that the Company was "executing against that strategy, and we're seeing [the] results in the deal quality and the customer quality," asserted that "our strategic investments in innovations and our go-to-market ecosystem positions us well for continued momentum," and that "there's no doubt there's [been] better execution" since the implementation of the turnaround strategy.
- Plaintiffs claim that, in truth, the strategy failed and UiPath's AI platform caused "confusion" among customers and was not able to be adequately scaled.
- The Complaint alleges Section 10(b) and 20(a) claims.

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Pouladian v. Vicor Corp., (N.D. Cal) (Filed 7/11/24)

- Vicor Corporation products are used to convert power from a primary source into the direct current needed by electronic circuits.
- Vicor's power conversion components were featured as part of major industry player's Artificial Intelligence chips
- Plaintiffs allege that in July of 2023, the company had told investors that a significant, "existing" contract would ramp up at the end of the year.
- In October 2023, the Company revealed that it had no "significant customer" contract, and that any company growth was expected to occur in 2025 or 2026.
- The Complaint alleges Section 10(b) and Section 20(a) claims.

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Hoare v. Oddity Tech, Ltd., (E.D.N.Y) (Filed 7/19/24)

- Oddity is an Israeli beauty and wellness products company.
- Plaintiff claims that the company overstated its artificial intelligence capabilities before its $424 million IPO in 2023.
- Plaintiffs alleged that short-seller, Ningi Research revealed in a report that Oddity's "AI is nothing but a questionnaire", "that Oddity's lauded 'repeat purchase rates' are attributable to 'customers unknowingly enter[ing] into non-cancelable plans' that allow the company 'to recognize repeat purchases in the following quarters even though the customers don't want the product'; and that Ningi had 'found hundreds of undisclosed lawsuits filed against Oddity."
- The Complaint alleges Section 10(b) and Section 20(a) claims.

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SEC Enforcement -- AI

- "AI Washing" has become a priority for the SEC, with several speeches and videos addressing the issue, along with four enforcement matters thus far:
  - In the Matters of Delphia (USA) Inc. & Global Predictions, Inc. (3/24)
  - In the Matter of Ilat Raz
  - In the Matter of QZ Global

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SEC Enforcement -- AI

- **In the Matters of Delphia (USA) Inc. & Global Predictions, Inc. (3/18/24)**
  - In March 2024, the SEC announced settlement of charges against two investment advisers, Delphia (USA) Inc. and Global Predictions Inc., for making false and misleading statements about their purported use of AI.
  - Charges stem from alleged "AI washing" whereby companies "mislead the public by saying they are using an AI model when they are not." Per the SEC:
    - Delphia claimed that it uses AI to "predict which companies and trends are about to make it big and invest in them before everyone else," but in reality, it lacked the AI and machine learning capabilities it claimed. The company agreed to pay a civil penalty of $225,000.
    - Global Predictions falsely claimed to be the "first regulated AI financial advisor" and misrepresented that its platform provided "[e]xpert AI-driven forecasts." The company agreed to pay a civil penalty of $175,000.

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SEC Enforcement -- AI

- **In the Matter of Ilit Raz (6/11/24)**
  - In June, the SEC charged Ilit Raz, CEO and founder of Joonko, an artificial intelligence recruitment startup, with fraud.
  - The SEC alleges that to raise money Raz made material misrepresentations about Joonko's business, including its customer and user base, its technology, and its revenues.
  - The misstatements included fake testimonials about the effectiveness of its "automated technology", and false claims that the Company was offering an "automated recruiting solution" that used "seven different AI algorithms" and "machine learning to improve the matching process as candidates select the roles they're interested in."

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SEC Enforcement -- AI

- **In the Matter of QZ Global Limited (8/27/24)**
  - On August 27, 2024, the SEC charged China-based investment adviser QZ Asset Management Limited a/k/a Qianze Asset Management Limited (QZ Asset), its South Dakota-based holding company QZ Global Limited, and the CEO of both entities, Blake Yeung Pu Lei a/k/a Yang Pulei (Yeung), with fraud.
  - The SEC alleged that QZ Asset and Yeung claimed that QZ Asset would use its proprietary AI-based technology to help generate extraordinary weekly returns while promising "100%" protection for client funds and that well-known and reputable financial and legal firms were providing services to the company.
  - Defendants also allegedly falsely claimed that they had applied to have QZ Global's common stock listed on the Nasdaq.

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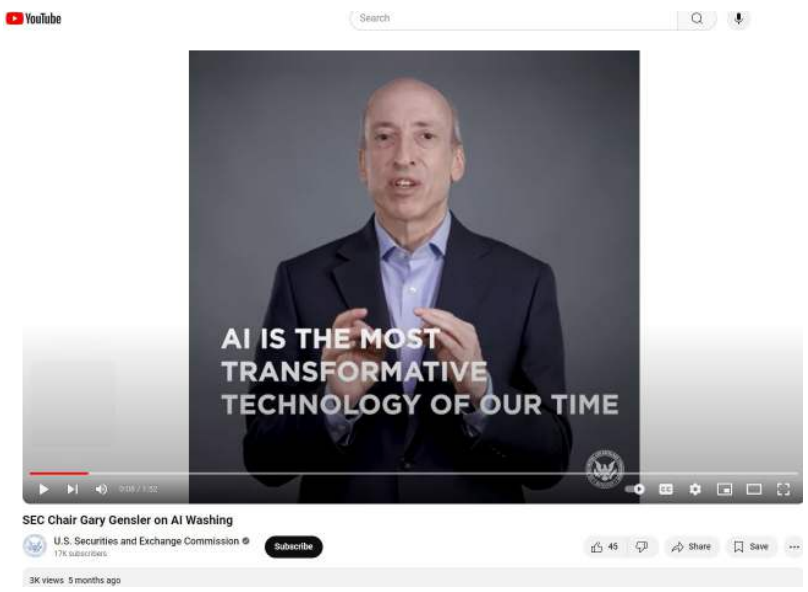
SEC Enforcement – AI

- Gary Gensler Video -- SEC Chair

  https://www.youtube.com/watch?v=4L_jxkZ9V6U



- Gurbir S. Grewal – Director, Division of Enforcement

  https://www.youtube.com/watch?v=nNLugYK3jrA

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AI Litigation Generally

- For a comprehensive discussion of AI litigation outside of the securities litigation and enforcement space:
  - **See AI Unleashed: Litigation Lightning Rod in the Generative Era, April 18, 2024 (Dailey LLP Presentation to ACCGP In-House Counsel Conference).**

  - **Presentation covered AI litigation areas, notable cases, litigation risks, and steps to mitigate risks.**

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Cyber Focused Securities Litigation and Enforcement

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Securities Litigation Filings - Cyber

- From 2020 to 2023, there were at least two securities class action suits filed each year related to a cybersecurity and/or customer privacy breach.
- While 2024 has seen several data breaches, securities class action filings in this area have been limited.

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Baxter v. PDD Holdings, E.D.N.Y. (Filed 8/13/24)

- Case included allegations related to several categories, including geopolitical, privacy, and cybersecurity.
- PDD is a Grand Cayman company with its headquarters in Ireland. The company operates the Pinduoduo platform in China. In September 2022, the company launched Temu, based in Boston, as a service to ship goods directly to consumers from Chinese factories. PDD's American Depositary Shares trade on Nasdaq.
- The company filings stated the company's commitment to compliance with laws regarding the collection and use of personal information. The company stated that it had adopted and implemented strict security policies and measures to protect customer data.

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Baxter v. PDD Holdings, E.D.N.Y. (Filed 8/13/24)

- Reports surfaced in March 2023 stating that the company's apps exploited Android system vulnerabilities to install backdoors and gain unauthorized access to user data, monitor activity in other apps, check notifications, read private messages, and change settings.
- Claims arising out of cybersecurity issues typically involve alleged disclosures about cyber intrusions by third parties.
- This case is different because it involves allegations that the defendant itself was actively using malware to circumvent cybersecurity controls.

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Securities Enforcement Landscape - Cyber

- It is unclear how the SEC will respond to the adverse trial court ruling in Solar Winds.
- Earlier this year the SEC entered into a significant settlement with RR Donnelly on similar claims.
- Internal and disclosure controls has been a focus for the SEC so it remains to be seen how they will react.

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Cyber Resources

- For a discussion of cyber litigation outside of the securities litigation and enforcement space:
  - **See Unmasking the Dark Web of Cybercrime, November 9, 2023 (Dailey LLP ACCGP Presentation).**

  - **Presentation covered common ways cybercrimes are committed, proactive steps counsel can take to prevent or mitigate attacks, steps to minimize disruption and liability.**

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Cases to Watch Regarding Pleading Requirements and Risk Factor Disclosures

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Cases to watch regarding pleading requirements and risk factor disclosures.

- Plaintiffs are increasingly bringing claims based on risk-factor disclosures in SEC filings.
- Risk factors and cautionary language should be reviewed to make sure that disclosures do not describe risks in hypothetical terms when the risks are alleged to have been actually occurring or to have occurred at the time.

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Cases to watch regarding pleading requirements and risk factor disclosures.

- On June 10, 2024, the Supreme Court granted certiorari in *Facebook, Inc. v. Amalgamated Bank* to review a decision by the Ninth Circuit Court of Appeals holding that Facebook could be held liable under Section 10(b) and Rule 10b-5 for failing to disclose risks that had materialized in the past but that presented no known risk of ongoing or future business harm.
- This case raises significant questions regarding the scope of corporate liability for risk disclosures and could potentially affect the nature and volume of investor lawsuits.

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Cases to watch regarding pleading requirements and risk factor disclosures.

- Facebook allegedly knew that Cambridge Analytica had improperly accessed and used Facebook users' data while Facebook's contemporaneous SEC filings disclosed in hypothetical terms the risk of improper third-party misuses of Facebook users' data.
- The 9th Circuit found Facebook's SEC filings misleading for representing the risk of improper access to or disclosure of Facebook data "as purely hypothetical when that exact risk had already transpired." The opinion concluded that a reasonable investor "would have understood the risk of a third party accessing and utilizing Facebook user data improperly to be merely conjectural."

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Cases to watch regarding pleading requirements and risk factor disclosures.

- *Facebook* relied on the 9th Circuit's earlier decision in *In re Alphabet*, 1 F.4th 687, 703-04 (9th Cir. 2021). There, the 9th Circuit held that allegations were sufficient to survive a motion to dismiss when the complaint plausibly alleged that the company's SEC filings "warned that risks 'could' occur when, in fact, those risks had already materialized."
- Alphabet had warned in its 2017 10-K that concerns about its privacy and security practices "could" harm its reputation and operating results. Alphabet later discovered a bug that threatened users' personal data. Nonetheless, Alphabet's SEC filings repeated the earlier risk factor warning, while also stating that there had been "no material changes" to its "risk factors."

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Cases to watch regarding pleading requirements and risk factor disclosures.

- A third 9th Circuit decision about a potential deal also highlights when risk disclosure statements might bring about securities litigation claims.
- In *Glazer Capital Management, L.P. v. Forescout Technologies, Inc.*, 63 F.4th 123, 137-38 (9th Cir. 2023), Forescout Technologies made positive statements about closing a pending merger with Advent International.
- What Forescout did not disclose is that Advent had advised Forescout that it was considering not closing. Forescout's filings included multiple warnings about the transaction and the risk of the merger not closing. But, the risk was presented as hypothetical at the same time that Forescout had notice that the merger might not, in fact, close.
- A company "cannot rely on boilerplate language describing hypothetical risks to avoid liability."

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Changes to Delaware Corporate law and The Impact on Board and Stockholder Governance

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Recent changes to Delaware Corporate law

- The amendments to the Delaware General Corporation Law (the "DGCL") were introduced in response to three significant decisions of the Delaware Court of Chancery.
  - Whether Section 251(b) of the DGCL required boards to approve the final execution version of a merger agreement? *Sjunde Ap-Fonden v. Activision Blizzard, Inc.*
  - Whether lost premium damages may be retained by the target company or distributed to shareholders? *Crispo v. Musk.*
  - Whether certain consent and other provisions in stockholder agreements that gave shareholders rights and restricted the ability of the board to manage the business and affairs of the corporation were facially invalid? *West Palm Beach Firefighters' Pension Fund v. Moelis & Co.*

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Recent changes to Delaware Corporate law (con't)

- The amendments were signed into law by Governor John Carney on July 17, 2024, and took effect on August 1, 2024.
- These amendments will apply retroactively to all contracts and agreements made by a Delaware corporation as well as all contracts, agreements, and documents approved by the board of directors of a Delaware corporation.

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Recent changes to Delaware Corporate (con't)

- **Whether Section 251(b) of the DGCL required boards to approve the final execution version of a merger agreement?** ***Sjunde Ap-Fonden v. Activision Blizzard, Inc.***
  - The Court acknowledged that it is common practice to present the target board with an incomplete but "near-final" version of the merger agreement for approval, given the realities of negotiating and executing a complex transaction.
  - But the Court concluded that market norms do not supersede statutory terms: "Where market practice exceeds the generous bounds of private ordering afforded by the DGCL, then market practice needs to check itself."

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Recent changes to Delaware Corporate law (con't)

- **New Section 147**. Whenever the board of directors' approval of an agreement or document is expressly required by the DGCL, such an agreement or document may be approved in its final or substantially final form.
- This is intended to enable a board to approve a transaction at a time when all material terms are set forth in the agreement.
- Also allows the board of directors to ratify previously approved agreements, even before those agreements are filed with the Delaware Secretary of State, as required by the DGCL.

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Recent changes to Delaware Corporate law (con't)

- **New Subsection 232(g).** Expressly incorporates any document that is annexed, appended, or enclosed with a stockholder notice regarding a merger or transaction approval as part of such stockholder notice.

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Recent changes to Delaware Corporate law (con't)

- **New Section 268.** In the context of a merger, if an agreement provides that the shares of capital stock of a corporation are converted into cash, property, rights, or securities in the merger, then:
  - the merger agreement approved by the board does not need to include any provision regarding the charter of the surviving corp to be considered in final or substantially final form;
  - an amendment or restatement of the charter of the surviving corp can be adopted by the board of the constituent corporation or any person acting at its direction; and
  - no change to such charter is deemed an amendment of the merger agreement.
- Excludes disclosure schedules or letters as part of merger agreements, allowing for more flexibility in negotiations without requiring formal approval in the statutory context.

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Recent changes to Delaware Corporate law (con't)

- **Whether lost premium damages may be retained by the target company? *Crispo v. Musk.***
  - Addressed challenges for target companies who seek to recover lost merger premiums in failed deals.
  - Case involved a Twitter stockholder and Elon Musk. Court analyzed whether a stockholder has standing to pursue a claim for breach of a merger agreement, under a provision that permitted recovery of a lost merger premium in the event of a buyer breach.
  - Deciding that the stockholder lacked standing, the court also noted that a contract for lost-premium provision which allows for the recovery of such damages by the target company is likely unenforceable.

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- **New Subsection 261(a)(1).** Provides for parties to a merger or acquisition agreement the statutory authorization to include penalties or other consequences for a breach of its provisions prior to the effective time listed in the agreement.
- These consequences may include an obligation to pay the loss of any premium or other economic entitlements the stockholders of the nonbreaching party would have received if the merger transaction had been consummated.
- A party receiving such a payment may retain it, and the payments need not be distributed to stockholders.

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Recent changes to Delaware Corporate law (con't)

- **Whether certain consent and other provisions in stockholder agreements that restricted the ability of the board to manage the business and affairs of the corporation were facially invalid? *West Palm Beach Firefighters' Pension Fund v. Moelis & Co.***
  - The Court of Chancery ruled that certain approval rights granted to a founding stockholder in a stockholders' agreement between the founder and the corporation, including consent rights over a broad range of corporate actions and the composition of the corporation's board of directors and board committees, were facially invalid as they impermissibly constrained the board of directors' authority.

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- The court reasoned that the approval rights violated Section 141(a) of the DGCL because the restrictive approval rights in the stockholders' agreement effectively constrained "in a very substantial way" the directors' ability to manage the corporation, and Section 141(a) of the DGCL provides that the business and affairs of a corporation must be managed by or under the direction of the board of directors unless otherwise specified in the DGCL or the corporation's certificate of incorporation.

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Recent changes to Delaware Corporate law (con't)

- **New Section 122(18).** Authorizes Delaware corporations to enter into agreements with stockholders and prospective stockholders, even if such agreements constrain the board's discretion, so long as such agreements do not violate the DGCL (other than Section 115 of the DGCL regarding forum selection) or the corporation's certificate of incorporation. These agreements may:
  - Restrict corporate actions under specified circumstances,
  - Require specific approvals before the board can take corporate action, and
  - Provide that the corporation, and its directors and stockholders, will take, or refrain from taking, particular actions.

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- Section 122(18) does not, however, eliminate fiduciary duties owed by directors, officers or controlling stockholders to the corporation.

- **New Section 122(5).** Amended to reaffirm that a board cannot delegate fundamental board-level functions to officers or agents unless authorized under the corporation's certificate of incorporation, maintaining the board's central role in corporate governance.

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Thank you.

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- **ACC Communities** - Easily connect and exchange information that is practice area or practice setting specific with other in-house counsel facing the same challenges as you. Join unlimited networks for free as a member.
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