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Insights Into Corporate Governance, M&A and Securities Law

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SEC Adopts Climate-Related Disclosure Rules


By **Erica Hogan**
Partner | Corporate


By **Erin Ward**
Law Clerk | Corporate

On March 6, 2024, the U.S. Securities and Exchange Commission (the "SEC") finalized and adopted rules on climate-related disclosures for public companies, including foreign private issuers, that are less onerous than the original proposed rules published by the SEC two years ago, but which still impose significant new reporting obligations on public companies. As set forth in a 886-page Release and summarized by an accompanying Fact Sheet, new subpart 1500 of Regulation S-K, *Climate-Related Disclosure*, and Article 14 of Regulation S-X will require public companies to provide both quantitative and qualitative disclosures relating to, among other items:

- Climate-related risks identified by the registrant that have had or are reasonably likely to have a material impact on the registrant, including on its strategy, results of operations or financial condition;

- The actual and potential material impacts of identified climate-related risks on the registrant's strategy, business model and outlook;

- Measures the registrant has taken to mitigate or adapt to a material climate-related risk and the costs and impacts resulting from such activities;

- The role of the board of directors and management in overseeing, assessing and managing material climate-related risks;

- Any processes or measures the registrant has in place for identifying, assessing and managing climate-related risks and how those processes have been integrated into the registrant's overall risk-management systems;

- Information about any climate-related targets or goals of the registrant, including the impacts of such targets or goals on the registrant's financial estimates and assumptions;

- The capitalized costs, expenditures, charges and losses incurred as a result of severe weather events and other natural conditions, if applicable; and

- The capitalized costs, expenditures and losses incurred as a result of carbon offsets and renewable energy credits or certificates, if applicable.

Additionally, large accelerated filers and certain accelerated filers not otherwise exempted are required to disclose information about material Scope 1 and/or Scope 2 emissions, which includes data related to greenhouse gas ("GHG") emissions. Registrants required to disclose such GHG emissions will also be required to file an assurance report (at a limited assurance level, and following a transitional phase-in period, at a reasonable assurance level).

The new disclosures must be included in registration statements and annual reports in both narrative and quantitative form, tagged in Inline XBRL. The disclosures will be required prospectively, meaning that information for prior periods will be required only to the extent such information was previously disclosed in an SEC filing, which may help facilitate the transition period.

While the new rules will require heightened climate-related disclosures in registration statements and annual reports, the final rules are scaled back from the SEC's previously proposed rules issued in March 2022, which received 24,000 comments and were the subject of substantial scrutiny and public debate. Among the most notable differences in the adopted rules as compared to the proposed rules are the more narrow financial statement disclosures and the limited scope of and number of registrants subject to GHG emission disclosures. As pertains to financial statement disclosures, registrants will be required to disclose only certain climate-related financial statement effects, as opposed to those effects on all affected line items as initially proposed. Registrants will be required to make these disclosures in a footnote to the audited financial statements and will not be required to make an assessment as to whether any events or conditions disclosed are related to climate change, as was to be required by the proposed rules. Furthermore, the finalized rules have added a materiality qualifier in determining the climate-related targets or goals requiring disclosure. Additionally, in contrast to the SEC's original proposal, the adopted rules include a materiality qualifier for Scope 1 and Scope 2 emissions and do not require registrants to disclose Scope 3 emissions. The final rules also provide a safe harbor for forward-looking climate-related disclosures, including disclosures regarding transition plans, scenario analysis, the use of an internal carbon price and the registrant's targets and goals other than disclosures that are historical facts. Accordingly, the safe harbor does not extend to disclosures pertaining to the company's actual Scope 1 and Scope 2 emissions or historical facts.

Notably, the rules were adopted in a 3-2 vote and SEC Commissioners Hester Peirce and Mark Uyeda expressed their views in opposition of the rule in dissenting statements, including Ms. Peirce who noted that the costs of the rule outweigh any benefits and suggested the Staff would be better served "re-proposing this rule not adopting it."

Immediately following its adoption, a group of 10 states filed a petition with the U.S. Court of Appeals for the Eleventh Circuit arguing that the new rules are unlawful and requesting that the Court vacate the rules. Additionally litigation has since been commenced in the U.S. Court of Appeals for the Fifth, Sixth and Eighth Circuits. On the opposite end of the spectrum, environmental groups have challenged the newly adopted rules for not going far enough to promote climate change. In *Liberty Energy Inc. v. Securities and Exchange Commission*, based on arguments that the compliance costs of the rules would cause the petitioners to incur irreparable injury, the U.S. Court of Appeals for the Fifth Circuit granted the petitioners' request seeking an administrative stay. On April 4, 2024, the SEC announced that it is voluntarily staying effectiveness of the Climate-Related Disclosure Rules pending the current legal challenges which, at the SEC's request, were consolidated in the Eighth Circuit.

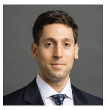
According to SEC Chair Gary Gensler, the new rules "will provide investors with consistent, comparable, and decision-useful information, and issuers with clear reporting requirements." The final rules were scheduled to go into effect May 28th, at which point the compliance dates would have been phased in for all registrants depending on the registrant's filer status as follows:

Registrant Type	**Disclosure and Financial Statement Effects Audit**[1]	**GHG Emissions/Assurance**

		Scopes 1 and 2 GHG Emissions	*Limited Assurance*	*Reasonable Assurance*
Large Accelerated Filers	FYB 2025[2]	FYB 2026	FYB 2029	FYB 2033
Accelerated Filers (other than SRCs and EGCs)	FYB 2026	FYB 2028	FYB 2031	N/A
SRCs, EGCs and Non-Accelerated Filers	FYB 2027	N/A	N/A	N/A
	1 Other than certain disclosures relating to Item 1502(d)(2), Item 1502(e)(and Item 1504(c)(2), which will be required one year following the dates listed. 2 As used in this chart, “FYB” refers to any fiscal year beginning in the calendar year listed.			

Challenges to the Corporate Transparency Act


By **Jodi Avergun**
Senior Counsel | White Collar Defense and Investigations


By **Peter Bariso**
Special Counsel | Corporate

The Corporate Transparency Act (the "CTA"), which became effective on January 1, 2024, requires certain domestic and foreign companies doing business in the United States to file a beneficial ownership report with the U.S. Treasury Department's Financial Crimes Enforcement Network ("FinCEN"). Reporting entities created or registered before 2024 will have until January 1, 2025 to file their initial beneficial ownership report. Reporting entities created or registered in 2024 will have 90 days from filing corporate registration documents with secretaries of state to file a beneficial ownership report with FinCEN. Thereafter, reporting entities created after January 1, 2025 will have thirty days from the initial filing of their registration documents to file beneficial ownership reports with FinCEN.

Earlier this month, in *National Small Business Association v. Yellen*, the United States District Court for the Northern District of Alabama found the CTA unconstitutional in part because the law "exceeds the Constitution's limits on the legislative branch" and thus is neither necessary or proper to achieve Congress' policy goals. The District Court rejected the government's contention that the CTA is a necessary and proper exercise of Congress' taxing power or its powers over commerce, foreign affairs or national security, finding that such a reading of the necessary and proper clause would "give Congress carte blanche to do as it pleases." The District Court found it unnecessary to address the plaintiffs' additional claims that the CTA also violates the First, Fourth and Fifth Amendments to the Constitution.

While the wording of the decision is broad, in fact, the decision only enjoins the Treasury Department from enforcing the CTA only with respect to the plaintiffs in the case. The government promptly appealed and FinCEN announced that it will "continue to implement the Corporate Transparency Act as required by Congress, while complying with the court's order."

At the state level, on March 1, 2024, New York Governor Kathy Hochul signed an amendment to the New York LLC Transparency Act ("NYTA"). The NYTA is modeled on the CTA, and addresses the same policy concerns as does the CTA, namely trying to prevent the use of anonymous LLCs in NY to hide various criminal activity. Unlike the CTA, which ostensibly applies to any kind of corporate entity, the NYTA only requires LLCs to provide beneficial ownership information. The recently-signed amendment makes all reporting provisions effective January 1, 2026, and limits disclosure of beneficial ownership information to law enforcement or as required by court order.

Since the Alabama decision in *National Small Business Association v. Yellen*, at least one other similar suit has been filed thus far. (*See*, *Small Business Association of Michigan*, *et al v. Yellen*,). It is not yet known if the Alabama case or the Michigan case will be part of a trend challenging the law, or what the federal appellate courts ultimately decide. The NYTA may also be subject to similar challenges. But for now, other than the specific plaintiffs in the National Small Business Association case, non-exempt reporting entities must follow the beneficial ownership provisions in the CTA.

West Palm Beach Firefighters' Pension Fund v. Moelis & Co.: An Affirmation of Statutory Board Authority


By **Jared Stanisci**
Partner | Global Litigation


By **Claire McGuinness**
Law Clerk | Corporate

The Delaware Court of Chancery decided two cases recently that may have a significant impact on future corporate action, in each stressing the need for corporate actors to follow statutory requirements, even when in potential tension with market practice. In a decision that may cause controlled companies to revisit existing stockholders agreements, the Delaware Court of Chancery in *West Palm Beach Firefighters' Pension Fund v. Moelis & Co.* found certain terms in Moelis & Co.'s stockholders agreement with its founder to be facially invalid. The Court acknowledged that it is common for private equity sponsors and other controlling stockholders to enter into agreements allowing holders to retain governance rights and exercise veto rights over certain corporate actions following an initial public offering but held that "[w]hen market practice meets a statute, the statute prevails. Market participants must conform their conduct to legal requirements, not the other way around."

In connection with the company's initial public offering in 2014, the company entered into a stockholder's agreement with Ken Moelis. Among other things, the stockholders' agreement granted certain rights to Mr. Moelis that the plaintiffs alleged were unenforceable under the Delaware General Corporation Law ("DGCL"), including (A) pre-approval requirements, which the Court highlighted required the company to obtain Mr. Moelis' consent "before taking eighteen different categories of actions", (B) board composition provisions, which granted to Mr. Moelis the right to designate a majority of the directors on the company board, and (C) committee composition requirements, which provided that each committee of the board would be majority comprised of Mr. Moelis' designees.

In its 131-page decision, the Court agreed with the plaintiffs' contention that the above mentioned provisions of the stockholders' agreement deprived the company's board of directors of a significant portion of its authority, in contravention of Section 141(a) of the DGCL, which provides, in relevant part, that "the business and affairs of every corporation organized . . . [in Delaware] shall be managed by or under the direction of a board of directors." Unlike external commercial contracts, the stockholders' agreement at issue and other internal corporate governance arrangements "that do not appear in the charter and deprive boards of a significant portion of their authority contravene Section 141(a)."

Based in part on prior Delaware decisions, the Court employed a two-part test.

First, the Court must determine whether the challenged provision is part of an external commercial agreement or one that seeks "to govern the corporation's internal affairs". If the former, a challenge based on a violation of Section 141(a) will likely be unsuccessful.

Second, if the provision involves an "internal governance arrangement," the Courts will apply the test espoused in *Abercrombie v. Davies*, which requires the Court to find that the governance restrictions at issue violate of DGCL Section 141(a) if such restrictions "have the effect of removing from the directors in a very substantial way their duty to use their own best judgment on management matters" or "tend[] to limit in a substantial way the freedom of director decisions on matters of management policy."

As to the first prong of the analysis, the Court identified a number of factors to distinguish between external commercial contracts and internal governance arrangements, including whether the agreement:

(i) has a statutory grounding in the DGCL (here, the Court noted that stockholders agreements specifically are grounded in DGCL Section 218);

(ii) is agreed to by intra-corporate actors (here, the Court highlighted that the only parties to the relevant agreement are the company, Mr. Moelis and certain other stockholders he controls);

(iii) seeks to specify how intra-corporate actors exercise corporate power, (here, the court noted the stockholders' agreement in question, prohibits actions that a director on the board could otherwise take and restricts voting in a particular way);

(iv) reflects "an underlying commercial exchange" or has a "commercial purpose" beyond mere governance rights (here, the Court distinguished supply agreements, credit agreements and other commercial arrangements from the stockholders agreement in question);

(v) provides for a remedy of damages tied to a commercial bargain, rather than an injunctive remedy enforcing governance rights; and

(vi) has an indefinite duration and/or cannot be readily terminated by the company.

After determining the stockholders agreement was clearly an internal governance arrangement, the Court reviewed the pre-approval requirements and held that the requirements force the board to obtain prior consent from Mr. Moelis "before taking virtually any meaningful action" and with such requirements in place, the board "is not really a board." The Court was not swayed by the defendants arguments that the restrictions at issue granted to Mr. Moelis only veto rights to block certain matters and not rights to approve actions.

As to the board and committee composition provisions, the Court found that certain aspects were also invalid, including, among others, the restrictions on board size and the obligation on the board to recommend candidates designated by Mr. Moelis without restriction. The Court noted that designation and nomination rights, on the other hand, are not facially invalid restrictions under DGCL Section 141.

While not expressly endorsing other alternatives, the board discussed other structuring options that may have been less problematic, including incorporating the restrictive provisions into the company's certificate of incorporation or issuing to Mr. Moelis preferred stock carrying specific rights.

Looking forward, both public and private companies should consider this decision when evaluating existing and prospective agreements that may encroach on board action and determine whether such provisions of agreements should be incorporated into the company's certificate of incorporation.

Sjunde AP-Fonden v. Activision Blizzard Inc.: What May be Common May not be Right


By **William Mills**
Partner | Corporate


By **Claire McGuinness**
Law Clerk | Corporate

In another impactful decision, the Delaware Court of Chancery in *Sjunde AP-Fonden v. Activision Blizzard Inc.* again stressed the importance of the statutory text of the DGCL to dismiss claims by the plaintiffs alleging that the board violated Section 251 of the DGCL in approving Activision Blizzard, Inc.'s merger with Microsoft, Corp. As with *Moelis*, the Court recognized the market practice that sophisticated parties may continue to negotiate and finalize agreements and disclosure schedules "up until the moment a deal closes, if not beyond" but noted that "[w]here market practice exceeds the generous bounds of private ordering afforded by the DGCL, then market practice needs to check itself."

In the case, the plaintiff alleged that the board of directors of Activision did not comply with the requirements in Section 251 of the DGCL in approving a merger agreement that was missing certain relevant sections necessary for execution, such as the newly formed company's charter and a company disclosure letter, a common practice in merger negotiations. The final merger agreement reflected the completion of those missing items, but Activision's board did not review and approve the final executed version of the agreement. Section 251(b) of the DGCL provides, in relevant part, that "the board of directors of each corporation which desires to merge or consolidate shall adopt a resolution approving an agreement of merger or consolidation and declaring its advisability" and requires that the merger agreement state certain terms.

Distinguishing between a true execution-ready agreement and what is required under Section 251(b), the Court held that "[a]t bare minimum Section 251(b) requires a board to approve an essentially complete version of the merger agreement." In agreement with the plaintiff, the Court found that the draft merger agreement approved by the board of directors of Activision was not "essentially complete" and did not yet include, among other items:

(i) the company disclosure letter or disclosure schedules;

(ii) the surviving company's charter;

(iii) the amount of consideration or Activision's name as the target, instead including placeholders for both (although the Court noted that these items are typically added at signing to preserve confidentiality); or

(iv) resolution as to whether Activision would be permitted to declare and pay dividends between the signing and closing of the merger.

The board met a day before the merger agreement was executed and approved the then-current draft, delegating to an *ad hoc* committee negotiation of the final dividend point. The final merger agreement executed the next day reflected the resolution of that issue and completion of the other missing items. Noting that under DGCL Section 141(c)(2), “no committee shall have the power or authority” to approve of any matter required to be submitted to stockholders, the Court held that the board erred by not approving the merger agreement after resolution of the final open items. In reviewing the claims in plaintiff’s motion for summary judgment, the Court held that it was “reasonably conceivable that the committee alone, and not the Board, approved the Dividend Provision” and “that the Board violated Section 141(c) by delegating to a committee approval of the Dividend Provision.”

The Court also refused to dismiss the plaintiff’s claim that the Activision board violated Section 251(c) of the DGCL, which states, in relevant part, that the merger agreement be submitted to the stockholders, that notice of a meeting shall be given, and that such “notice shall contain a copy of the agreement or a brief summary thereof.” The Court found that Activision’s notice did not meet either option required by Section 251(c) because (1) the merger agreement attached to the proxy statement for the stockholder meeting did not comply with Section 251(b) in that the agreement did not include the charter for the surviving corporation, and (2) the stockholder notice did not contain a summary of the merger agreement. The Court agreed with the defendant that the proxy statement itself included a detailed summary of the merger agreement but again relying on a strict construction of the statute, held that “the proxy statement is not the notice.”

Looking forward, both acquirors and target companies should pay close attention to statutory requirements for approval of merger agreements and, if applicable, consider holding final board meetings, or reapproving or ratifying agreements once all documents, exhibits and schedules are in final form with no open or missing items.