

## *GT Insights* for Public Companies



September 5, 2018

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### **SEC Regulation**

#### **SEC Adopts Rules Aimed at Simplifying Disclosures**

On [Aug. 17, 2018](#), the SEC adopted amendments to certain disclosure requirements that have become “redundant, duplicative, overlapping, outdated, or superseded” in light of other SEC disclosure requirements, U.S. GAAP, International Financial Reporting Standards, or changes in the information environment. The amendments aim to streamline information to investors and reduce compliance burdens for companies.

As discussed below, many disclosure items required by both Regulation S-K and Regulation S-X have been eliminated or relocated from the business section to the notes of the financial statements. However, disclosure that is newly relocated to the financial statements will now become subject to audit or review, internal control over financial reporting and XBRL requirements. Further, since the safe harbor for forward-looking statements under the Private Securities Litigation Reform Act of 1995 does not apply to disclosure in the financial statements, moving forward-looking statements to the financial statements may create additional liability for issuers.

The amendments include the following significant changes:

### **Business Section**

- eliminated the requirement for financial information about segments and by geographic area in the business section of a prospectus or periodic report (will continue to be required in the notes to the financial statements);
- eliminated the requirement for R&D expense in the business section of a prospectus or periodic report (similar disclosure will continue to be required in the notes to the financial statements and if material, the MD&A);
- eliminated the requirement to disclose risks associated with foreign operations and any segment's dependence on foreign operations (disclosure will continue to be required, if material, in risk factors and MD&A was amended to reference geographic areas); and
- eliminated the requirement for a geographic breakdown of revenues and assets in the business section of a prospectus or periodic report (will continue to be required in the notes to the financial statements).

### **Information Environment**

- eliminated the requirement to disclose high and low trading prices for common stock in the past two years in prospectuses and annual reports;
- eliminated the requirement to disclose the frequency and amount of cash dividends (Regulation S-X was amended to require disclosure in interim financial statements);
- disclosure of restrictions on the payment of dividends will now be included only in the notes to the financial statements;
- eliminated the requirement to disclose the availability of the information through the SEC Public Reference Room; and
- added the requirement to disclose the company website (previously disclosure was voluntary).

### **Other**

- eliminated the requirement to discuss seasonality in the MD&A of interim reports unless otherwise material; and
- eliminated the requirement to provide the ratio of earnings to fixed charges when registering debt or preferred stock, in corresponding registration statements and periodic reports.

With regard to overlapping disclosure under both Regulation S-K and GAAP, the Staff has referred certain items to FASB for potential incorporation into GAAP including:

- Disclosure about major customers; and
- Revenue from products and services.

In response to comments, the Staff did not refer legal proceedings and loss contingencies to FASB for integration, but will retain the current separate requirements and will study the issue further.

The amendments will be effective 30 days after publication in the Federal Register.

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## **SEC Division of Corporation Finance to Publicly Release Additional Staff Actions**

The SEC's Division of Corporation Finance recently **announced** that it will publicly post in issuers' EDGAR filing histories a range of documents relating to staff actions taken with respect to those issuers. The Division also will take steps to release via EDGAR other documents relating to actions taken by the SEC or by Division staff that currently are available elsewhere on the SEC's website. This announcement corresponds with the Division's June announcement that it will post serious deficiency letters (commonly known as "bedbug letters") shortly after the letter is issued to a registrant where a registration statement or offering document is so deficient that the Division is deferring its review of the filing until it is amended to resolve the deficiencies.

Starting Oct. 1, 2018, the Division will begin to release through EDGAR orders it issues granting or denying regulatory relief on behalf of the SEC, including the following items:

- orders declaring a registration statement abandoned pursuant to Securities Act Rule 479;
- orders declaring an offering statement abandoned pursuant to Regulation A Rule 259;
- orders accelerating the effective date of qualification of trust indentures filed pursuant to Trust Indenture Act Section 307;
- orders accelerating the effective date of Exchange Act Section 12(b) registration statements;
- orders accelerating the effective date of Exchange Act Section 12(g) registration statements;
- orders granting exemptions from tender offer provisions of Sections 13(e) and 14(d)(1) through 14(d)(7) of the Exchange Act; and
- orders granting exemptions from certain tender offer rules in Regulation 14E.

Most importantly, the SEC noted that it intends to continue its efforts to enhance transparency in subsequent phases by releasing additional types of documents, including those memorializing actions or positions taken by the Division staff, such as interpretive guidance and no-action relief.

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## SEC Seeks Public Comment on Ways to Modernize Compensatory Offerings

The Securities and Exchange Commission (SEC or the Commission) issued a [concept release](#) on July 18, 2018 to solicit public comments on ways to modernize compensatory offerings and sales of securities exempted under Rule 701 or registered on Form S-8, consistent with investor protection. Rule 701 provides an exemption from Securities Act registration requirements for securities issued in compensatory arrangements by non-reporting companies to officers, directors, employees, consultants and advisors. Form S-8 is a registration statement used by SEC reporting companies for compensatory offerings to such individuals. Below are some of the key questions raised by the concept release.

### *Rule 701 – Keeping Pace with the Gig Economy*

One of the interesting questions raised in the concept release relates to how, or if, Rule 701 should be updated to reflect the development of the “gig economy.” The gig economy is characterized by contractual relationships between companies and individuals involving short-term, part-time, or freelance arrangements. Typically, this involves an individual’s use of the company’s Internet “platform” for a fee to find business such as providing services to end users, ride-sharing, food delivery, lodging, and car rentals. These individuals may have similar relationships with multiple companies. They may not be “employees” in a traditional sense or qualify as consultants, advisors or de facto employees. Following are some of the comments on this topic solicited by the concept release include:

- whether the definition of “employee” under other regulatory regimes should apply for Rule 701 purposes;
- what, if any, services an individual working in the gig economy should provide to the company to be eligible under Rule 701;
- what would constitute a sufficient nexus between the individual and the company to justify application of the exemption for compensatory transactions;
- should the individual’s level of dependence on the company or the company’s degree of dependence on the individual be considered;
- the potential impact of increased volume of Rule 701 issuances if the rule were to be revised to accommodate companies involved in the gig economy; and
- whether having a separate ceiling or additional disclosures would be appropriate for companies in the gig economy.

### *Form S-8 Questions Raised*

Some of the comments on Form S-8 solicited by the concept release include the following:

- whether to make corresponding changes to Form S-8, to the extent Rule 701 eligibility was extended to include individuals participating in the gig economy;
- ways to further reduce administrative burdens associated with registration on Form S-8 and whether such revisions would encourage more companies to become reporting companies;
- whether Form S-8 should allow a company to use a single form to register offers and sales for all employee benefit plans it sponsors;
- whether there should be a “pay-as-you-go” fee structure for Form S-8 registration statements (similar to what is permitted for well-known seasoned issuers) or payment of registration fees on a periodic basis;
- whether the current operation of Form S-8 presents significant challenges to the use of benefit plans; and
- what the advantages, disadvantages, and impact would be of eliminating Form S-8 and instead allowing reporting companies to use Rule 701.

### *Rule 701(e) Disclosure Requirements*

The SEC also amended Rule 701(e) to increase the trigger for certain disclosures to \$10 million in aggregate sales of securities sold during a 12-month period. If a company’s issuances exceed that amount, the company is required to provide certain heightened disclosure to investors a reasonable period of time prior to the sale. Among other things, the concept release requests comments relating to the timing and manner of such disclosures and whether the consequence for failure to deliver the disclosures continues to be a loss of the exemption for the entire offering, or only for transactions in offerings that occur after the threshold is crossed and for which disclosure was not provided.

### *Restricted Stock Units*

RSUs may settle without the recipient taking any action. Therefore, the SEC noted that the investment decision, if any, likely takes place on the date of grant. The obligation to deliver disclosures at a reasonable time before the grant date of the RSU award could compel disclosure of financial information to potential new hires at a time when they are negotiating their employment terms. The concept release asks when disclosure should be required for RSUs. In addition, the concept release seeks comment on what the appropriate valuation for RSUs is for the purpose of Rule 701, as well as whether any other types of derivative instruments should be specifically addressed by Rule 701.

### *Rule 701(d) Exemptive Conditions*

The concept release also seeks comment on whether the Rule 701 “hard cap” - greater of 15 percent of total assets, 15 percent of the total outstanding amount of the class of securities being offered and sold in reliance on the rule, subject to a \$1 million annual cap if greater than either of these tests - is unduly restrictive and whether the annual ceiling should be raised or eliminated altogether.

SEC Chairman, Jay Clayton said, “The rule as amended, and the concept release, are responsive to the fact that the American economy is rapidly evolving, including through the development of both new compensatory instruments and novel worker relationships - often referred to as the ‘gig economy.’ We must do all we can to ensure our regulatory framework reflects changes in our marketplace, including our labor markets.” The comment period is open until Sept. 24, 2018.

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## **SEC Proposal Concerning Simplified Disclosure in Registered Debt Offerings**

In late July, the **SEC proposed amendments** to Regulation S-X intended to simplify the financial disclosure obligations for guarantors, issuers of guaranteed securities, and certain affiliates in registered debt offerings. Specifically, the proposals seek to amend Rules 3-10 and 3-16 of Regulation S-X.

Currently, Rule 3-10 provides several exceptions to the underlying requirement that financial statements be filed for all issuers and guarantors of registered securities; these exceptions are typically available for individual subsidiaries of a parent company, subject to certain conditions. The proposals amend these conditions in ways that help subsidiaries take advantage of these exceptions. For example, the proposal replaces the condition that a subsidiary be 100 percent owned by the parent with a condition that it only be consolidated in the parent's consolidated financial statements. In addition, the proposal amends the parent's financial reporting obligations as they relate to the particular subsidiary seeking the exception.

Similarly, the proposed amendments to Rule 3-16 help minimize the parent's burden with regard to its reporting of the financial statements of its collateral-holding affiliates. For example, while the current regime requires that separate financials be provided for each affiliate whose securities are pledged as collateral, the proposal permits that disclosure can be provided as a supplement to the parent's consolidated financial statements.

The **proposal** is subject to a 60-day public comment period.

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## **Exempt Solicitations: New C&DIs Address Notices Provided on a Voluntary Basis**

In recent years, and particularly during the 2018 proxy season, institutional and individual investors have increasingly voluntarily used Notices of Exempt Solicitation, which are filed on EDGAR, under Exchange Act Rule 14a-6(g) as a platform to publicize shareholder views on proposals being presented to shareholders. Rule 14a-6(g) requires a person who owns more than \$5 million of the company's securities and conducts an exempt solicitation of the company's stockholders to file all solicitation materials with the SEC. Historically, these voluntary filings escaped regulatory scrutiny. However, given the perceived abuse, on July 31, 2018, the Division of Corporation Finance (the Staff) issued two new Compliance and Disclosure Interpretations (C&DIs) on exempt solicitations to address voluntary exempt solicitations.

In C&DI Question **126.06**, the Staff confirmed that a Notice of Exempt Solicitation may be provided on a voluntary basis by persons who do not own more than \$5 million of a company's securities, if the cover of the notice clearly states that the notice is being provided on a voluntary basis.

In C&DI Question **126.07**, the Staff confirmed that all of the information required by Rule 14a-103 in the Notice of Exempt Solicitation must be presented before any written soliciting materials, including any logos or graphics used by the soliciting party. Rule 14a-103 requires that the filer provide the name of the company subject to the soliciting material and the name and address of the person relying on the exemption. To the extent that the notice itself is being used as a means of solicitation, the Staff further noted that failure to present the Notice of Exempt Solicitation in accordance with C&DI 126.07 may, depending on facts and circumstances, be considered misleading within the meaning of Exchange Act Rule 14a-9.

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## **Argentina Classified as a Highly Inflationary Economy Under US GAAP**

Companies with significant operations in Argentina should consider how uncertainties regarding those operations may affect their current and future consolidated financial statements, especially in light of the fact that Argentina has recently been classified as a "**highly inflationary economy**" under Accounting Standards Codification (ASC) 830, *Foreign Currency Matters*. These companies must apply the accounting guidance for highly inflationary economies during their fiscal quarter beginning July 1, 2018 (i.e., the reporting period following the period in which the economy became highly inflationary).

ASC 830-10-45-11 defines a highly inflationary economy as an economy that has a cumulative inflation rate of approximately 100 percent or more over a three-year period. Where the calculation results in the cumulative inflation rate being less than 100 percent, historical inflation rate trends (increasing or decreasing) and other pertinent economic factors should be considered to determine if the economy is highly inflationary. Accordingly, once a country's economy is classified as highly inflationary and a



decrease in the cumulative three-year rate below 100 percent occurs, entities should evaluate the economic conditions in that country to determine whether the change in circumstances is not temporary.

Under ASC 830, a foreign entity operating in Argentina whose functional currency is the Argentinian peso must change its functional currency to that of its immediate parent company for consolidation purposes. If the change in the functional currency will have a material effect on the entity's financial statements, it is appropriate to disclose the effect of Argentina's economic situation in the Management's Discussion and Analysis and/or the notes to the financial statements.

Reporting entities must have sufficient processes and controls to monitor the inflation in Argentina. In addition to the cumulative inflation rates, reporting entities should monitor the **devaluation** of the Argentinian peso and the fact that (i) the Argentinian Central Bank recently increased interest rates to **40 percent**, (ii) the problematic historical indices have a minimal impact on the cumulative inflation rate calculation, and (iii) the International Monetary Fund (the IMF) recently provided Argentina with a **\$50 billion credit line** (the biggest loan in the IMF's history).

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## **SEC Issues Final Rule to Amend FOIA Regulations**

On **June 25, 2018**, the SEC adopted amendments to its rules related to the Freedom of Information Act (FOIA). The changes become effective on July 30, 2018. The amendments to the regulations make certain SEC records available to the public and are designed to (i) reflect changes required by the FOIA Improvement Act of 2016, (ii) clarify procedures for submitting FOIA requests and administrative appeals, (iii) revise the fee procedures and schedule, and (iv) eliminate repetitive provisions that merely restate provisions from the FOIA statute.

For those seeking to protect the confidentiality of documents, Section 200.80(c) of the new rules provides that a "request for records may be denied to the extent the exemptions in 5 U.S.C. 552(b) apply to the requested records" and the "(A) Commission staff reasonably foresees that disclosure would harm an interest protected by the applicable exemption; or (B) The disclosure of the requested records is prohibited by law or is exempt from disclosure under 5 U.S.C. 552(b)(3)." This covers the exemption for "trade secrets and commercial or financial information obtained from a person and privileged or confidential" contained in 5 U.S.C. 552(b)(4) – an exemption on which confidential treatment requests commonly rely.

With respect to the elimination of certain provisions under the superseded regulations, the amendments remove (1) the list of information required to be published by the Commission in the Federal Register under FOIA (Section 200.80(a)(1) of the superseded regulations), (2) the categories of records FOIA requires the Commission to make available for public inspection (Section 200.80(a)(2) of the superseded regulations), and (3) the nine categories of records that are exempt from disclosure under 5 U.S.C. 552(b) (Section 200.80(b) of the superseded regulations).

While these changes are non-substantive, those preparing confidential treatment requests will need to update legends and other references in such requests to delete citations to the soon-to-be-defunct 200.80(b)(4) (and review any other references to FOIA rules) and consider instead whether another reference is appropriate, such as to the statute itself or to 200.80(c).

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## **Corporate Governance**

### **ISS Annual Policy Survey**

On July 30, 2018, ISS opened its **Annual Policy Survey** to institutional investors, corporate issuers, corporate directors, consultants/advisors to corporate issuers and others. The survey comprises two parts: governance principles and policy application.

The governance principles survey focuses on:

- factors that could be considered in evaluation of the independence and performance of the external auditor;
- considerations in evaluating a company's audit committee;
- situations where a director has failed in his or her oversight responsibilities, which may trigger a negative recommendation under current ISS policy and cause a note to be published in that individual director's *other* boards proxy research report;
- gender-diversity on boards, including what actions would be appropriate to take at companies that lack any gender diversity and/or have not disclosed a policy on the issue; and
- multi-class capital structures that yield unequal voting rights structures.

The policy application survey is much more detailed and targets regional considerations. The [survey](#) for the United States focuses on:

- factors in evaluating an independent chair;
- minimum stock ownership for shareholders who want to propose amendments to bylaws;
- metrics used in ISS' pay-for-performance analysis;
- rationalization for high non-executive director compensation; and
- level of disclosure about a director's individual skills and attributes.

The high-level portion of the survey closed on August 24, 2018 at 5:00 pm EST and the detailed, regional portion of the survey closes on September 21, 2018 at 5:00 pm EST. ISS will also gather information via roundtable conversations and calls.

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## Delaware Passes Voluntary Sustainability Certification Act

In late June, Delaware passed the [Delaware Certification of Adoption of Transparency and Sustainability Standards Act](#) (Act), which will become effective on Oct. 1, 2018. The Act provides Delaware-governed entities with a platform to exhibit to their investors, customers, clients, and other stakeholders their commitment to social responsibility and sustainability. The Act is entirely voluntary and only applies to those Delaware entities that seek to become certified as reporting entities. For those companies choosing to be certified, the key requirement under the Act is that their respective governing bodies approve standards to assess the impact of company activities on society and the environment and create assessment measures by which the companies can measure their performance, all of which are to be made publicly available. The Act does not govern the substantive nature of the standards but rather permits companies to tailor standards to the specific needs of their industry and business. In addition, companies must also pay a nominal fee and file annual renewal statements.

The Act does not create any specific fines or penalties for a reporting entity's failure to comply with its own standards, nor does it give any party the right to bring claims for an entity's decision to become or remain (or not to become or remain) a reporting entity. However, any person who files false statements under the Act may be liable for perjury.

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## Accounting

### Center for Audit Quality Releases FAQs on CAMS

In July 2018, the Center for Audit Quality published "[Key Concepts and FAQs for Audit Committees, Investors, and Other Users of Financial Statements](#)" to assist in understanding the new critical audit matters (CAM) requirement. Specifically, auditor reports issued after certain dates must include disclosure on CAMs relating to the current period presented. The effective dates for including CAMs in the auditor's report are:

- For audits of large accelerated filers – fiscal years ending on or after June 30, 2019; and
- For audits of all other companies to which CAM requirements apply – fiscal years ending on or after Dec. 15, 2020

The CAM requirements do not apply to the audits of emerging growth companies, brokers and dealers reporting under Exchange Act Rule 17a-5, investment companies other than business development companies, and benefit plans. CAMs may be communicated in auditors' reports voluntarily before the required effective date.

The new auditing standard, *AS 3101*, defines CAMs as any matter arising from the audit of the financial statement that was communicated or required to be communicated to the audit committee and that:

- Relates to accounts or disclosures that are material to the financial statements; and
- Involved especially challenging, subjective, or complex auditor judgment.

The phrase “relates to” means that for a matter to be deemed a CAM, that matter must relate to an account or disclosure that is material to the financial statements. The matter can be a component of an account or disclosure. Additionally, a matter not related to a single account or disclosure could be considered a CAM if it has a pervasive effect on the financial statements.

The identification of a matter as a CAM is principles-based. As such, *AS 3101* does not specify matters that would always be classified as a CAM. For instance, a matter that is determined to be a significant risk but does not involve especially challenging, subjective, or complex auditor judgment is not necessarily a CAM. In determining whether a matter includes especially challenging, subjective, or complex auditor judgment, the auditor must take into account certain nonexclusive factors such as the auditor's assessment of the risks of material misstatements.

The new standard requires that auditors add introductory language preceding the CAM section in the auditor's report. For each CAM communicated in the auditor's report, the auditor must:

- identify the CAM;
- describe the principal considerations that led the auditor to determine that the matter is a CAM;
- describe how the CAM was addressed in the audit; and
- refer to the relevant financial statement accounts or disclosures that relate to the CAM.

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## SEC Enforcement

### SEC Enters Settlement Regarding Perquisite Policies and Procedures

On July 2, 2018, the SEC entered into an Offer of Settlement with a company regarding its perquisite policies and disclosures in its annual proxy statements spanning from 2012 to 2016. During that time, the company's perquisite standard was based on a “business purpose” test, whereby a legitimate business purpose was a sufficient reason to determine that a benefit was not a perquisite that required disclosure. However, the company's policy did not follow the SEC's standard regarding disclosure of perquisites, which provides that:

- an item is not a perquisite or personal benefit if it is integrally and directly related to the performance of the executive's duties; and
- otherwise an item is a perquisite or personal benefit if it confers a direct or indirect benefit that has a personal aspect without regard to whether it may be provided for some business reason or



for the convenience of the company, unless it is generally available on a non-discriminatory basis to all employees.

In addition to using the incorrect perquisite standard, the Commission found that the company:

- did not train employees who were responsible for disclosure; and
- had inadequate processes and procedures to ensure proper reporting.

As a result, nearly \$3 million of perquisites were omitted from the company's proxy disclosure, including travel to outside board meetings, sporting events, personal events, club memberships, limited use of personal assistant office time, and membership fees to sit on the board of a charitable organization.

In light of this information, the company agreed to:

- retain, at the company's own expense, for a period of one year, an independent consultant to conduct a review of the company's policies, procedures, controls, and training relating to perquisites under the securities laws, including the Commission's rules and standards; and
- pay a civil money penalty in the amount of \$1.75 million to the SEC.

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## **6 State Treasurers Oppose Forced Arbitration Clauses in Joint Letter to SEC Chair Clayton**

In a [July 2, 2018 joint letter](#) to SEC Chair Jay Clayton signed by a coalition of state treasurers from the States of California, Illinois, Iowa, Oregon, Pennsylvania, and Rhode Island, the state treasurers urged Chair Clayton not to take up the issue of allowing companies to adopt forced arbitration clauses for shareholder securities actions. Alternatively, if the SEC did take up the issue, the joint letter urged Chair Clayton to uphold what they referred to as the SEC's long-standing policy against such clauses. The letter cites Commissioner Piwowar's July 2017 speech at the Heritage Foundation during which he stated he would encourage companies to seek relief from the Staff to include mandatory arbitration clauses in their organizational documents.

The state treasurers claim that forced arbitration clauses undermine the ability of investors to seek redress for securities law violations and combat financial misconduct, conceal the proceedings from the public lens and impact investor confidence in the markets. The SEC and others have recently expressed mixed views on the topic. See this [GT Insights Article](#) for a discussion of various recent speeches and a Treasury Department report on the subject.

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## **Litigation**

### **The Delaware Court of Chancery Holds That an Informal Email Exchange Between Members Effected the Dissolution of a Limited Liability Company**

Dissolution is a major event in the corporate lifecycle and is often viewed in formalistic terms. As the Court of Chancery recently explained, however, even seemingly informal email exchanges between the appropriate parties can effect the dissolution of an LLC when there is no written operating agreement that prescribes a different procedure or requirement. More specifically, the court held that the members' email exchange was sufficient to effect dissolution of the company by consent.

The LLC was organized by two life-long friends to operate an insurance agency. The plaintiff member was a corporate entity controlled by one friend, and the defendant member was the other friend. Although the structure of the plaintiff member was somewhat complex, it ultimately did not factor into the outcome of the case because the communications between the individual friends were deemed attributable to the LLC members for purposes of the court's conclusion.

A dispute arose over the conduct of the business, leading the plaintiff member to bring fiduciary duty claims against the defendant member (each of whom held a 50 percent ownership interest) and to seek judicial dissolution of the LLC. The defendant member counterclaimed, asserting fraud and fiduciary duty claims against both the plaintiff member and his friend.

During the run-up to those filings, various disputes arose about how the business was being run, including multiple occasions of the defendant failing to obtain new insurance policies and thus leaving gaps in the insured's coverage. After expressing dissatisfaction with the situation, the two principals exchanged emails concerning the status of the company. One wrote "I would propose we just unwind what we were going to do with [the company] and you will get 50 percent of the commissions and keep everything you earn..." Later that day, the other principal responded "Ok. 50 percent is fine...Tell me how I can get out of the way. Several questions need to be cleared up." The plaintiff then sent a letter purporting to terminate defendant's employment with the company.

In its post-trial opinion, the Delaware Court of Chancery concluded (among other things) that, given the lack of an operating agreement that prescribed a different procedure or requirement, the members had effected dissolution of the LLC by consent through their email correspondence. The correspondence was deemed to be sufficient evidence of "consent" under Section 18-801(a)(3) of the Delaware Limited Liability Company Act, which provides that an LLC is dissolved upon the vote or consent of members who own more than 2/3 of the then-current percentage or other interest in the profits of the limited liability company owned by all of the members, unless otherwise provided in the limited liability company agreement of the LLC.

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## **Delaware High Court Rejects Business Judgement Due to Material Omissions in Public Disclosure**

On July 9, 2018, the Delaware Supreme Court reversed a lower court's decision to dismiss a stockholder suit brought by an investor of a company after the company's acquisition via tender offer, saying the lower court erred in finding that stockholders were fully informed when voting to tender their shares. Although the transaction was approved by a majority of disinterested board members and a majority of the minority stockholders, the Supreme Court found that the company's omission of material information in its public filings precluded the lower court from using the more lenient and irrebuttable business judgment standard to evaluate the transaction. In order for such director-friendly standard to apply, the stockholders must be fully informed when voting on a merger or deciding to tender their shares.

The Supreme Court stated that the company's stockholders had not been given all material information because facts about the company founder's involvement in negotiations with the acquirer were left out of public documents. For instance, the filings omitted information about the founder's preference for a rollover transaction with the acquirer in order to preserve his equity.

In rejecting the business judgement rule, the Supreme Court held the omitted information would have altered the total mix of information available to stockholders before voting their shares, stating "A reasonable stockholder would have found these facts material because they would have shed light on the depth of the [founder's] commitment to acquirer, the extent of [the founder's] and [the acquirer's] pressure on the board, and the degree that this influence may have impacted the structure of the sale process."

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