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M&A, Activism and Corporate Governance

QUARTERLY REVIEW

Introduction

The *M&A, Activism and Corporate Governance Quarterly Review* is Mayer Brown's quarterly publication designed to keep you current on key legal developments involving mergers and acquisitions, shareholder activism and corporate governance matters.

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In This Issue

Illumina and the Quest for GRAIL: The Search for Merger Clearance in an Increasingly Aggressive—and Global—Antitrust Enforcement Environment

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The long and tortured regulatory-review path for Illumina, Inc.'s $7.1 billion acquisition of GRAIL, Inc. demonstrates the current climate of intense global antitrust scrutiny of transactions. The combination raises so-called "vertical" antitrust issues in that it combines firms at different levels of a supply chain. Illumina provides DNA sequencing tools used in the development and commercialization of multicancer early detection tests ("MCED" tests), while GRAIL is a downstream developer and provider of those MCED tests. Antitrust regulators in the United States and the European Union have been focusing on whether the deal would provide Illumina, the allegedly dominant supplier of a critical input in MCED test development, with the incentive and ability to disadvantage GRAIL's MCED rivals.

The deal, first announced in September 2020, triggered in-depth reviews in both the United States and European Union. On August 18, 2021, nearly a year after announcement, the parties closed the transaction. They did so despite the EU and US regulatory reviews remaining open and active. With regard to the European Union, Illumina justified closing the deal by taking the position that it did not believe the European Commission nor its member states had jurisdiction over the transaction, given that GRAIL has no business in the European Union. The European Commission continued its inquiry and on September 6, 2022, issued a ruling prohibiting the acquisition. It also accused the parties of improperly closing the transaction while the investigation was pending, potentially subjecting them to the maximum fine that the European Commission can impose (10% of Illumina's annual revenue) and informed the parties of its intention to use "restorative measures" to unwind the completed deal.

The review in the United States has been similarly fraught. Following a "second request" investigation, the Federal Trade Commission ("FTC"), in March 2021, filed a complaint challenging the deal in its administrative court. The FTC Administrative Law Judge ("ALJ") conducted a trial, hearing testimony from 56 fact witnesses and 10 expert witnesses and receiving over 4,500 exhibits into evidence. On September 9, 2022, the ALJ issued a detailed opinion, finding, on the facts, that FTC counsel had failed to prove its case. However, under established procedure for matters under the FTC's jurisdiction, the matter then went on appeal back to the full FTC—the same body that initially issued the complaint. On April 3, 2023, the FTC overturned the ALJ's findings and concluded that the acquisition was anticompetitive. It further ordered the parties to unwind the transaction.

As of the time of this publication, Illumina is appealing the FTC's decision to the US Court of Appeals for the Fifth Circuit. It also is appealing the European Commission's assertion of jurisdiction over the transaction and its substantive objections to the deal. Rulings are expected in these proceedings by the end of 2023 or beginning of 2024.

While it may take over a year for these proceedings to conclude, several important lessons are evident:

Government Enforcers Are Suspicious of Remedies to Counter Alleged Anticompetitive Effects

Illumina and GRAIL attempted to mitigate the purported competitive harms by proposing a conduct remedy. In essence, Illumina agreed to provide a twelve-year long-term supply agreement to its for-profit US oncology customers that would provide protections on service, supply, pricing, intellectual property, and confidentiality. The ALJ concluded that this "Open Offer" effectively addressed the competitive harms caused by the transaction in that it would keep Illumina from raising costs to, or otherwise foreclosing, GRAIL's rivals.

The FTC disagreed, however, both with how the ALJ addressed the remedy as a matter of process and with his substantive conclusion. The FTC concluded that enforcers must prove that a proposed transaction is anticompetitive—without consideration of any remedies offered after announcement—and parties must then prove that a remedy addresses the competitive harm. This puts the FTC in conflict with federal courts: in September 2022, in *United States v. UnitedHealth Grp. Inc.*, the US District Court for the District of Columbia came to the opposite conclusion—that enforcers must prove that the proposed transaction, plus any remedies offered after announcement, are anticompetitive. In addition, in the case of Illumina/GRAIL, the FTC concluded that the remedy would not restore a pre-acquisition level of competition. This puts into action statements by AAG Jonathan Kanter and FTC Chair Lina Khan that remedies short of blocking deals, particularly behavioral remedies, are disfavored.

Antitrust Enforcers Around the World Are Coordinating, but Are They "Colluding?"

In early 2023, the U.S. Chamber of Commerce (the "Chamber") published 332 records it obtained following protracted litigation of a 2022 FOIA request for communications between the FTC and enforcers outside the United States regarding the Illumina/GRAIL transaction. Shortly after publication of these records, Illumina requested that the ALJ reopen the record to admit additional documents, which Illumina argued raised due process concerns because the documents indicated that the FTC was potentially improperly coordinating with foreign antitrust authorities. The Chamber alleged that the competition enforcers were engaged in "forum shopping," with the European Union taking action soon after the ALJ had approved the deal. A Chamber official was quoted as stating, "[I]t appears that what's occurring here with the Federal Trade Commission isn't international regulatory cooperation. Instead, it's international regulatory collusion."[1]

Illumina then made similar assertions in its briefing once the case arrived before the FTC on appeal. The FTC dismissed those due process concerns, finding "nothing improper" about the correspondence among FTC staff and other enforcers, which the FTC said was "specifically contemplated by international agreements and authorized by Congress." Commissioner Wilson, who was not always in lockstep with the other commissioners

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[1] Khushita Vasant, *U.S. Chamber Says FTC Engaged in "International Regulatory Collusion" over Illumina-Grail Merger*, MLex Market Insight (Feb. 25, 2023), https://mlexmarketinsight.com/news/insight/us-chamber-says-ftc-engaged-in-international-regulatory-collusion-over-illumina-grail-merger.

and stepped down from her position on March 31, 2023, agreed and wrote in her concurrence that, in this case, the communication between international antitrust enforcers was “beneficial for consumers, merging parties, and the development of sound antitrust law.” Though, Commissioner Wilson’s concurrence did acknowledge that antitrust enforcers do not have blanket authority to engage in any type of communication, and that communications that “facilitate forum shopping on the part of the US government” could be deemed to be improper.

At the time of this publication, Illumina and GRAIL stated in their petition to the Fifth Circuit that they are appealing “all aspects” of the FTC’s decision, which presumably includes these due process concerns. We may not have heard the last of the debate on government coordination vs. collusion.

The FTC Has a Distinct Advantage on Appeal

This matter highlights an important procedural twist that differentiates FTC actions from those brought by the Antitrust Division of the Department of Justice (the “DOJ”). Both agencies have the ability to review transactions under the US antitrust laws, and the agencies themselves decide which one will handle each specific matter (so-called “clearance”). That decision can have significant procedural consequences.

The US federal courts play a central role in reviewing antitrust enforcement actions by both agencies. However, the DOJ is a law enforcement agency that has no adjudicative power on its own; thus, to block a proposed deal following the end of the pre-merger Hart-Scott-Rodino (“HSR”) waiting period, the DOJ must file an action in a federal district (trial) court. The DOJ has the burden of proof and the Article III judge is a neutral-fact finder. The court is the arbiter of whether the law has been violated and, if so, orders appropriate remedies, including permanently blocking the transaction from closing.

The process is somewhat different in matters the FTC handles. Unlike the DOJ, the FTC can refer a matter to its own administrative tribunal. In that process, an administrative law judge conducts a trial and issues findings. That order can then be appealed to the FTC, which can then issue an order. The FTC administrative process, however, takes substantial time to play out. The agency does not have the ability to preliminarily enjoin a merger; it must wait for the completion of the process. Accordingly, in most merger matters, the FTC seeks a preliminary injunction from a federal district court to block the deal from closing during the pendency of the FTC administrative review. Practically, if the FTC obtains such an injunction, then parties usually abandon the deal rather than hold it open for the length of the administrative review.

The twist in Illumina/GRAIL, however, was that the parties initially kept the deal open given the European Union review. So, the FTC proceeded with the administrative review without seeking a federal court injunction. Even after the parties closed the deal over the European Union review, the FTC continued with its own process and issued its order to unwind the deal.

But, unlike with DOJ proceedings, there is no final, neutral decision-maker. Even after a full trial before the ALJ, the FTC is not required to give deference to the ALJ’s factual determinations; it reviews both the legal and factual issues *de novo*.

The defendant can appeal the FTC’s decision to any federal circuit court in whose jurisdictional region the defendant does business. This is not, however, a “do-over” in federal court; instead, the FTC’s decision receives deference from the appellate court in that questions of law are reviewed *de novo* but factual determinations made by the FTC are not challenged provided that they are supported by substantial evidence. Given that antitrust matters often turn on the facts, this can be a critical—and often decisive—advantage for the FTC.

Even with this procedural benefit, circuit courts do not always find for the FTC. Indeed, circuit courts tend to take a more critical look when the FTC has overturned ALJ determinations. In a case involving the same ALJ that heard Illumina/GRAIL, the Eleventh Circuit, in reversing the FTC's determination, explained that, although the substantial evidence standard still applied, the court may "examine the FTC's findings more closely when they differ from those of the ALJ" and stressed that the review encapsulates the entire record, including the ALJ's decision.[2]

We will see if Illumina is able to achieve a similar outcome.

Antitrust Issues Can Draw the Attention of Shareholder Activists

The Illumina/GRAIL transaction has caught the attention of more than just the antitrust regulators and courts. Carl Icahn has launched a proxy contest at Illumina. Icahn has published a series of open letters to Illumina shareholders over the course of March and April 2023, criticizing Illumina for pursuing the GRAIL acquisition despite regulatory opposition. As of the time of this publication, Icahn is calling for Illumina's CEO to be ousted, for three Icahn-nominated candidates to be added to the Illumina board of directors, and for Illumina and GRAIL to be "separated immediately," stating that the effort to overturn both the FTC and European Commission actions would be "an almost impossible battle" to win. Illumina has stated that Icahn's letters do not reflect an understanding of the regulatory process, and that Illumina expects to "execute a divestiture based on the terms of the final order, expeditiously and in a manner that services the best interest of Illumina's shareholders, unless Illumina wins the jurisdictional appeal in the meanwhile".

Takeaways

Illumina/GRAIL provides a case-study in the challenges facing mergers in the current climate of aggressive, global antitrust enforcement. In considering future deals, companies and their advisors should keep in mind and plan for:

- antitrust concerns that reach beyond combinations of direct competitors; as Illumina/GRAIL teaches, the enforcers are increasingly skeptical of "vertical" transactions and non-traditional theories of harm;
- global enforcers exercising jurisdiction over more and more matters and working together in ways that may increase the risk of a deal being blocked;
- enforcers taking a dim view of remedies, and
- ever-increasing length of regulatory reviews with all the risks associated with such delays, including potentially drawing attention and criticism from shareholder activists.

[2] Schering-Plough Corp. v. F.T.C., 402 F.3d 1056, 1061-62 (11th Cir. 2005) (citing Universal Camera Corp. v. NLRB, 340 US 474, 487-88 (1951)). In Universal Camera, the Supreme Court stated: "[E]vidence supporting a conclusion may be less substantial when an impartial, experienced [ALJ] who has observed the witness and lived with the case has drawn conclusions different from the [Commission's] than when he has reached the same conclusions." 340 US at 496.

Limited Partners and Selling Shareholders: Beware of Post-Closing Unjust Enrichment Claims

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There are several contractual provisions that sellers often use to limit their liability for post-closing claims brought by a buyer in the context of a private company purchase agreement. Reliance disclaimers, non-survival of representations and warranties, exclusive remedy, and no-recourse provisions in their typical forms, however, only go so far in court. Even where there is no explicit carve-out for fraud claims, as a matter of "public policy," Delaware courts have generally not enforced contract provisions that prevent a buyer from asserting fraud claims against sellers and/or their affiliates for making false representations and warranties or knowing that representations and warranties made by other seller parties were false.

A consequence of this judicial approach is that it has exposed limited partners and selling shareholders to derivative unjust enrichment claims, of which there have been an increasing number of cases over the last several years. These unjust enrichment claims have proven difficult to dismiss at the pleading stage, thereby exposing affiliates to precisely the type of protracted litigation that, in many cases, the contracting parties agreed that seller affiliates should not have to face. In light of this, sellers and their counsel should consider adding contractual language to specifically preclude unjust enrichment claims that are not dependent upon any proof of wrongdoing. The law in Delaware remains unsettled on the extent to which explicit protections against such claims would result in their prompt dismissal, but at the least, their inclusion may make buyers less apt to file the claims in the first place and make courts more willing to reject them.

Common Contractual Limitations on Post-Closing Claims

Purchase agreements frequently contain provisions aimed at limiting a buyer's ability to pursue legal claims post-closing, including—but not limited to—claims against affiliates of the seller who are not parties to the contract. Three of the most common such provisions are:

- *No-Survival Clauses*: By providing that a seller's representations and warranties expire upon closing, "no survival" provisions generally prevent contractual breach-of-warranty claims.
- *Reliance Disclaimers*: By stating that a buyer disclaims reliance on any representations and warranties not expressly set forth in the purchase agreement, reliance disclaimers effectively limit the universe of statements on which a buyer can plausibly base a claim that it was defrauded to only the express representations and warranties in the written agreement itself.
- *Exclusive Remedy Provisions*: By limiting the remedy available for breaches of representations and warranties and other contract provisions—for example, to indemnification from funds held in escrow—"exclusive remedy" provisions limit the buyer's ability to pursue claims for legal damages.

- *No-Recourse Provisions*: By providing that only the parties to the written contract can sue or be sued on claims arising from or relating to it, "no recourse" provisions seek to insulate non-signatory officers, directors, and affiliates from litigation arising from the transaction.

At their most seller-friendly, such provisions could, if applied strictly, preclude buyers from pursuing virtually any post-closing legal claims. However, litigation of post-closing claims persists for several reasons, as discussed below.

The Persistent Availability of Post-Closing Fraud Claims

First, fraud claims are often expressly exempted from certain contractual limitations. Though fraud carve-out provisions often endeavour to define actionable fraud as narrowly as possible, they nonetheless provide buyers with an avenue to assert post-closing fraud claims in one form or another. For example, an exclusive remedy provision may apply "except in the case of fraud," in which case a legal claim for damages beyond contractual indemnification can be maintained.

Second, Delaware courts generally decline to dismiss certain fraud claims even when they are barred by the express terms of an agreement. In its seminal 2006 decision in *ABRY Partners V, L.P. v. F&W Acquisition LLC*, the Delaware Chancery Court held that "[t]o the extent that the [Agreement] purports to limit the Seller's exposure for its own conscious participation in the communication of lies to the Buyer, it is invalid under the public policy of th[e] state." 891 A.2d 1032 (Del. Ch. 2006). Since that 2006 case—which the Delaware Supreme Court adopted in its 2021 decision in *Express Scripts, Inc. v. Bracket Holdings Corp.*—Delaware courts have consistently refused to enforce contractual limitations that bar fraud claims based on knowingly false misrepresentations contained within a purchase agreement.

The upshot of the *ABRY Partners* doctrine is that, no matter the extent of contractual limitations on post-closing claims, fraud claims remain viable, provided the buyer can plausibly allege that the defendants knowingly made false representations and warranties, or knew that representations and warranties were false. This is not a particularly high bar given that all the buyer must do is allege facts making it "reasonably conceivable" that the defendants knew that their representations were false. *See Online HealthNow, Inc. v. CIP OCL Investments, LLC*, 2021 WL 3557857, at *10 (Del. Ch. Aug. 12, 2021). In short, post-closing fraud claims cannot be fully circumvented in Delaware, and as a result, buyers often make use of them.

Derivative Unjust Enrichment Claims Against "Innocent" Shareholders

The ever-present availability of fraud claims does more than just prevent parties from contractually insulating allegedly intentional wrongdoers from suit. One less-discussed consequence of the *ABRY Partners* doctrine is that it also frequently permits buyers to maintain unjust enrichment claims against "innocent" shareholders and other seller affiliates who are alleged to have benefitted from the sale but may have had no role in perpetrating the alleged fraud. This result is troublesome because it can lead to unsuspecting parties being dragged into protracted and expensive litigation from which the purchase agreement purports to insulate them.

In general, an unjust enrichment claim accuses the defendant of benefitting from wrongful conduct to the plaintiff's detriment, but does not require the defendant to have participated in the wrongful conduct. While the existence of an express contract governing the subject matter of the claim typically precludes a party from asserting an unjust enrichment claim, there is a key exception to that rule: if the contract itself allegedly arose from wrongdoing (as in the case of a fraudulent inducement claim based on false representations and warranties), the contract's existence will not preclude unjust enrichment claims against beneficiaries of a transaction.

It has thus become common for buyers to invoke this exception and assert claims of unjust enrichment against a transaction's beneficiaries alongside claims of fraud. To date, Delaware courts have proven hesitant to dismiss these claims at the pleading stage, which subjects shareholders and other seller affiliates to expensive and burdensome discovery, despite not being a party to the agreement and often having the expectation that their exposure to litigation is limited.

Strategies for Protecting Shareholders from Post-Closing Unjust Enrichment Claims

Sellers and their counsel should consider specifically addressing unjust enrichment and similar claims that can derive from allegations of fraud when negotiating limitations on post-closing claims. The Chancery Court has acknowledged the possibility that the terms of a contract might prohibit equitable unjust enrichment claims, but the court did not actually rule upon the issue in either instance. *See Great Hill Equity Partners IV, LP v. SIG Growth Equity Fund I, LLP*, 2014 WL 6703980, at *25-28 (Del. Ch. Nov. 26, 2014); *LVI Grp. Invs., LLC v. NCM Grp. Holdings, LLC*, 2018 WL 1559936, at *17 (Del. Ch. Mar. 28, 2018). While the enforceability of such provisions is somewhat uncertain for now, it is reasonable to expect that the more explicit the contractual prohibition on equitable claims is, the more likely courts would be to deny such claims. Even if the court does not make a determination on the enforceability of such language, including an explicit disclaimer in the agreement would be expected to discourage at least some buyers from pursuing such claims.

Below in **bold** text are several suggested additions to sample contractual provisions that could help bolster a seller's case for dismissal of post-closing unjust enrichment claims at the pleading stage:

- <u>"Fraud"</u>: . . . Any claim for Fraud brought under this Agreement shall require proving each of the elements set forth in clauses (a) through (c) of the foregoing sentence with respect to each individual purported to be involved, **and no Party shall be liable for or as a result of any other Person's Fraud, including through equitable claims (such as unjust enrichment) not requiring proof of wrongdoing committed by the subject of such claims**.
- <u>Release</u>: . . . Notwithstanding the foregoing, each Buyer Releasor and its respective heirs, legal representatives, successors and assigns (x) retains, and does not release, its rights and interests under the terms of this Agreement and the Related Agreements **with respect to Seller Releasees that are Contracting Parties and (y) acknowledges and agrees that no Seller Releasee shall have any shared or vicarious liability, or otherwise be the subject of legal or equitable claims, for the actions, omissions, or fraud of any other Person** . . . .
- <u>Non-Recourse Persons</u>: . . . Notwithstanding anything that may be expressed or implied in this Agreement or the Related Agreements to the contrary, Buyer acknowledges and agrees that . . .; (ii) **in no event shall any Contracting Party have any shared or vicarious liability, or otherwise be the subject of legal or equitable claims, for the actions, omissions, or fraud of any other Person;** (iii) none of the Associated Persons of Seller, the Company, or the Subsidiaries (other than the Contracting Parties) (collectively, the "<u>Non-Recourse Persons</u>") shall have any Liability arising under, out of or by reason of, connected with or related in any manner to this Agreement, the Related Agreements or any documents or instruments delivered hereunder or thereunder or for any claim based on, in respect of or by reason of this Agreement, the Related Agreements, or any documents or instruments delivered hereunder or thereunder, or their negotiation, execution,

performance, non-performance or breach, and Buyer, both for itself and its Associated Persons and their respective successors and assigns, waives and releases all such Liabilities against any such Non-Recourse Persons**, including any and all causes of action arising from or otherwise relating to such Non-Recourse Persons' receipt of consideration or other benefits from this Agreement and the transaction contemplated thereby** . . . .

Special Purpose Acquisition Companies Continue to Face Headwinds

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The slowdown in special purpose acquisition company ("SPAC") initial public offerings ("IPOs") and SPAC business combination transactions ("de-SPAC transactions") and the increase in SPAC dissolutions that were seen in 2022 has continued into 2023. After a burgeoning SPAC market in 2020 and 2021, investors, regulators and courts have applied increasing challenges and scrutiny to SPACs and de-SPAC transactions. Below, we highlight certain trends emerging in the SPAC market and recent legal developments with respect to SPACs and de-SPAC transactions.

State of the SPAC Market: Observations on Q1 2023[1]

The first quarter of 2023 priced ten SPAC IPOs with aggregate gross proceeds of approximately $738 million. This is a substantial slowdown and decrease in capital raised as compared to just a year earlier in Q1 2022, when 55 SPAC IPOs were priced with aggregate gross proceeds of approximately $9 billion, and this represents a continued slowdown from Q4 2022, when eight IPOs were priced with aggregate gross proceeds of approximately $600 million. The trend seen in recent quarters of there being an equal or greater number of withdrawn IPOs as compared to priced IPOs continued to be present in Q1 2023, which brought 21 withdrawn IPOs (as compared to 55 priced IPOs).

De-SPAC transaction values have also continued to decrease over the last year. The aggregate equity value of de-SPAC transactions announced during Q1 2023 was approximately $22.5 billion, with an average equity value of approximately $479 million per transaction—this is a stark contrast to Q1 2022's aggregate equity value of $41.8 billion, and its average equity value per transaction of $1.23 billion. Q1 2023 also saw a sharp uptick in SPAC liquidations: 71 SPACs were dissolved in Q1 2023 alone, while a total of 145 SPACs were dissolved in all of fiscal year 2022. Private investment in public equity ("PIPE") participation in de-SPAC transactions was also markedly down with only 20% of de-SPAC transactions, including a PIPE investment in Q1 2023, whereas 59% of de-SPAC transactions in Q1 2022 had PIPE participation.

A combination of factors contributed to the sustained slowdown in SPAC activity and the drop in capital raised and PIPE participation in connection with SPAC transactions—among them include macroeconomic uncertainty brought about by inflation, rising interest rates and recessionary fears. However, macroeconomic factors are not only to blame—SPAC transactions have received increasing scrutiny from the U.S. Securities and Exchange Commission as well as US courts, with a recent court decision ruling

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[1] Data as of March 31, 2023 from *Deal Point Data, SPAC Track*.

against SPAC sponsors (described further below). Further, as of the end of Q1 2023, approximately 90% of de-SPACed companies that went public between 2019 and Q1 2023 were trading below their IPO price.

SPAC Litigation

Delman v. GigAcquisitions 3, LLC ("Delman")[2]

In January 2023, the Delaware Court of Chancery declined to dismiss a plaintiff's claims against a SPAC's sponsor and its directors for breach of fiduciary duty in connection with a de-SPAC transaction. *Delman* is notable because the SPAC, the de-SPAC transaction structure and the course of conduct that are the subject of the case are similar to those of other Delaware SPACs and de-SPAC transactions, and the issues presented in *Delman* are likely to be faced by other Delaware SPACs and their sponsors going forward.[3] *Delman* also reaffirmed that, as a practical matter, Delaware courts will review de-SPAC transactions through the same lens they would apply to review any other transaction requiring an investment decision by stockholders of a Delaware corporation and that directors of Delaware SPACs owe the same fiduciary duties to their stockholders as the directors of any other Delaware corporation, notwithstanding the unique structures of SPACs and de-SPAC transactions.

With respect to the standard of review used to evaluate whether the defendants complied with their fiduciary duties, the court determined that the business judgment rule was not applicable and that the entire fairness standard applied, due to the inherent conflicts of interest between the SPAC's sponsor and the SPAC's stockholders. The court reached this conclusion based on two independent grounds: (1) the sponsor was a controlling stockholder of the SPAC and (2) a majority of the SPAC's board was not disinterested and independent.

The court determined that it was reasonably conceivable that the de-SPAC transaction was a conflicted controller transaction because:

- The sponsor had complete control of the SPAC from creation through the de-SPAC transaction;
- The sponsor had the opportunity to extract something uniquely valuable to itself in the de-SPAC transaction at the expense of the public stockholders by receiving an "enormous" return on its investment in the SPAC even if the de-SPAC transaction was unfavorable to the public stockholders; and
- The sponsor had an interest in minimizing common stock redemptions by the public stockholders (which would have been paid out of the SPAC's trust account) because the closing of the de-SPAC transaction was conditioned on the SPAC contributing at least $150 million in cash at closing, $50 million of which was required to come from the SPAC's trust account.

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[2] *Delman v. GigAcquisitions 3, LLC* (Del. Ch. January 4, 2023).

[3] In a typical SPAC IPO, the SPAC issues units consisting of a share of stock and a warrant to purchase a fraction of a share. IPO proceeds are kept in a trust account for the benefit of the holders of shares issued in the IPO and before the SPAC completes a de-SPAC transaction, such holders have the opportunity to redeem their shares for their pro rata portion of the funds held in trust. Notwithstanding whether a holder redeems its shares, it is entitled to keep the warrant.

In finding that it was reasonably conceivable that a majority of the SPAC's board of directors was not disinterested and independent, the court emphasized the following factors:

- The SPAC's chairman and chief executive officer (the "SPAC Founder") was a director of the SPAC, and, along with his wife, who was also a SPAC director, stood to receive a material financial benefit in the de-SPAC transaction through his ownership and control of the SPAC's sponsor (the court calculated the sponsor's return to be 155,900% on its initial $25,000 investment in the SPAC); and
- Despite being paid in cash for their services as directors, the remaining directors on the SPAC's board held multiple positions with other sponsors and portfolio companies controlled by the SPAC Founder, which raised sufficient reason to doubt that they were independent of him.

The defendants argued that, if entire fairness applied because of board-level conflicts, the plaintiff's claims should be dismissed because the SPAC board's decision to engage in the de-SPAC transaction was subject to business judgment deference under Delaware's *Corwin* doctrine.[4] Rather than rejecting the defendants' argument solely because the de-SPAC transaction involved a conflicted controlling stockholder or because the plaintiff had presented well-pled disclosure deficiencies (described below), the court also determined that *Corwin* cleansing was not available to the defendants because the SPAC's inherent structure separated the stockholders' voting and economic interests by allowing stockholders to vote to approve the de-SPAC transaction and also redeem their shares before closing. The court found that the SPAC structure itself encouraged stockholders that redeemed their shares to nevertheless vote to approve the de-SPAC transaction in order to preserve the value of the warrants included in the SPAC IPO units.

In its entire fairness analysis, the court determined that plaintiffs sufficiently pleaded alleged failures to disclose in the SPAC's proxy statement certain facts material to a stockholder's decision of whether to redeem its shares, which failures contributed to the court's conclusion that dismissal of the plaintiff's claims was not appropriate, including the following:

- The SPAC had failed to accurately describe the actual value of SPAC shares for public stockholders that decided not to redeem their shares in the de-SPAC transaction. The proxy statement indicated that the value of SPAC stock of non-redeeming stockholders would be $10 per share in the de-SPACed company going forward. However, the court viewed that statement as materially misleading because the $10 figure failed to disclose and account for the significant per share dilution associated with, among other things, the reduction of the SPAC's cash due to the payment of transaction costs (including financial advisor fees) and the value of the SPAC's warrants, as well as the increase in the number of shares outstanding, including the shares issued to the sponsor, IPO underwriters and insiders, as well as the PIPE shares;[5] and
- The proxy statement included unrealistic revenue and production projections that effectively kept stockholders "in the dark about what they could realistically expect from the combined company"

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[4] In the Delaware Supreme Court's decision in *Corwin v. KKR Financial Holdings LLC* (Del. 2015), the Court held that, other than with respect to a self-dealing transaction involving a controlling stockholder, a fully informed vote of the disinterested and uncoerced stockholders will result in the business judgment rule applying to the transaction.

[5] The plaintiffs alleged that using this methodology, the actual per share value was $5.25.

after closing. The court stated that the SPAC board accepted an inflated valuation for the target company premised on unrealistic projections and then gave this misinformation to stockholders. The court noted that the problem with the projections is that they were not counterbalanced by "impartial information" that would have helped stockholders assess the risk of their investment and that even though the nature of the target company's business model could have been known by the kind of due diligence that is expected of the board of a Delaware corporation engaged in a major transaction, the SPAC board was incentivized to turn a blind eye to the target company's problems. Accordingly, it was reasonably conceivable that the stockholders did not receive an accurate view of the target company's financial health.

With *Delman*, the Delaware Court of Chancery has made clear that traditional and well-worn fiduciary duty principles apply to SPACs and de-SPAC transactions. The SPAC structure used in the case is typical of other Delaware-incorporated SPACs, and de-SPAC transactions involving such SPACs appear to be ineligible for business judgment deference and, by their nature, will be subject to entire fairness review. In addition, the *Delman* court has clarified certain types of information that is required to be disclosed to SPAC stockholders in connection with their decision of whether to redeem their shares in connection with a de-SPAC transaction. As a result of this case and other SPAC decisions of the Chancery Court of Delaware, sponsors may be incentivized to organize their SPACs outside of Delaware going forward.[6]

Garfield v. Boxed, Inc. ("Boxed")[7]

In December 2022, the Delaware Court of Chancery ruled in *Boxed* that, pursuant to Section 242(b)(2) of the Delaware General Corporation Law (the "DGCL"), a SPAC with Class A and Class B common stock was required to seek a separate class vote of the Class A common stock, in addition to the vote of the common stockholders voting together, when amending the SPAC's certificate of incorporation to increase the number of authorized shares of Class A common stock. While many Delaware SPACs have been incorporated with two classes of common stock, prior to the *Boxed* decision, many such SPACs had not sought a separate class vote in similar circumstances and the failure to obtain such approvals cast doubt on the validity of the certificate of incorporation amendments and issuances of shares of common stock by these SPACs in connection with their de-SPAC transactions.

Following the *Boxed* decision, many companies petitioned the Delaware Court of Chancery pursuant to Section 205 of the DGCL[8] to remedy the defective stockholder votes obtained in connection with de-SPAC transactions and the court has begun to grant the relief sought by de-SPACed petitioners. In the first of its opinions granting such relief,[9] the court noted that "billions of shares [had been] issued" in situations similar to the company in *Boxed* and the failure to grant relief would "invite untold chaos" causing similarly

[6] Following *Delman*, the Delaware Court of Chancery issued another decision in *Laidlaw v. GigAcquisitions2, LLC* (Del. Ch. March 1, 2023) which reflected very similar facts and circumstances as *Delman*. Using the same rationale first described in *Delman*, the court applied an entire fairness review to the plaintiff's claims and denied the defendants' motion to dismiss.

[7] *Garfield v. Boxed, Inc.* (Del. Ch. December 27, 2022).

[8] Section 205 of the DGCL allows Delaware corporations to petition and seek relief from the Delaware Court of Chancery to validate defective corporate acts that would otherwise be void or voidable.

[9] *In re Lordstown Motors Corp.* (Del. Ch. February 21, 2023).

situated companies to otherwise "face difficulties in filing Form 10-Ks and the possibility of stock exchange delisting." The court also noted that, where the factors contemplated by Section 205(b) of the DGCL were satisfied, there did not appear to be "any legitimate harm that would result from validating" the amendment to the company's certificate of incorporation and that "absent validation, a number of parties would face widespread harm." In light of the significant risks resulting from the *Boxed* decision faced by de-SPACed companies that were formerly dual-class SPACs and the court's subsequent decisions and rationale for ratifying defective stockholder votes, we would expect the court to continue to grant relief under Section 205 for companies that find themselves in similar circumstances.

Deadline Extensions for De-SPAC Transactions

The vast majority of SPAC charters contain a deadline by which a SPAC must complete a business combination.[10] If a SPAC has not completed a business combination by the deadline, the SPAC must cease all operations except for the purpose of winding up. In that case, SPACs are required to return the funds remaining in the IPO trust account (net of any amounts permitted by the charter to be removed for taxes and dissolution expenses) to public stockholders via redemption. To avoid this result, SPACs that are approaching their deadline can seek to extend their deadline by obtaining stockholder approval to amend their charter and obtain more time to complete a business combination.[11] In order to compensate public stockholders for the additional time requested, SPACs often offer to deposit additional funds into their trust accounts on the theory that eventually (upon completion of a business combination or a later dissolution) public stockholders will have the opportunity to acquire these funds via redemption.

The first quarter of 2023 remained on trend with many SPACs seeking such extensions. Extensions have become more common as many SPACs that were formed during the SPAC boom years of 2020 and especially 2021 are now approaching their deadlines.

When a SPAC seeks shareholder approval for a charter extension amendment, it is obligated to offer public stockholders the opportunity to redeem their shares upon adoption of the amendment. However, SPAC charters also provide that no redemption may occur to the extent that it would result in the SPAC having less than $5,000,001 in net tangible assets.[12] When the number of stockholders exercising their redemption rights is high, it can lead to a "catch-22" where a SPAC has the votes necessary[13] to effect a charter

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[10] SPACs are required to complete a business combination within 36 months or face delisting on the relevant securities exchange. See NYSE Rule 102.06 and Nasdaq Rule 5101-2. However, conditions in the equity markets have forced virtually all SPACs to include a much shorter time frame (12 months or even shorter in some cases). The SEC has proposed rule changes relating to the Investment Company Act of 1940 which have the effect of putting a SPAC in jeopardy of being deemed an investment company if either (i) it has not filed an 8-K disclosing an agreement to engage in a business combination transaction within 18 months of its IPO registration statement's effective date; or (ii) it has not completed a business combination within 24 months of its IPO registration statement's effective date.

[11] Some SPAC charters have a built in mechanism under which the SPAC's deadline may be extended without a stockholder vote for a limited additional time upon the deposit by the sponsor of additional funds into the trust account. Once these "automatic" extensions are exhausted, a SPAC can still seek a stockholder vote to amend the charter and get even more time.

[12] SPACs include this requirement in order to avoid being classified a "blank check company" under Rule 419 promulgated under the Securities Act of 1933, as amended.

[13] In Delaware, the vote required for this type of amendment is usually a majority of the outstanding common stock entitled to vote thereon. See DGCL § 242(b)(1).

amendment for an extension, but the number of redemptions would reduce a SPAC's net tangible assets below the required amount. In that case, a SPAC may be legally unable to adopt the amendment necessary to extend its deadline, and the SPAC would be forced to liquidate instead. SPACs facing this situation have undertaken a variety of maneuvers and transactions designed to avoid this result, including entering into non-redemption agreements with certain shareholders or forward purchase agreements with new or existing investors, seeking waivers to significant deferred liabilities and obtaining additional capital from the SPAC's sponsor. These strategies have differing advantages and disadvantages, and there are many factors to consider, not least of which is the SPAC's ability to satisfy the continued listing requirements of the NYSE or Nasdaq and its prospects for timely consummating a de-SPAC transaction. The best course of action for any particular SPAC considering an extension will depend on the SPAC's objectives and the surrounding circumstances.

The Increasing Importance of Foreign Direct Investment Regulation in M&A Transactions

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In recent years, factors such as the desire to protect critical industries, cybersecurity threats and other geopolitical concerns have resulted in the global proliferation of foreign direct investment ("FDI") reporting, screening, and review mechanisms. Dozens of countries have an FDI regulatory regime in place, and governments have shown an increasing willingness to deploy these regimes to review and potentially block or impose conditions on cross-border deals. Beyond FDI, policymakers in certain jurisdictions are considering the creation of *outbound* investment screening and/or review mechanisms, which could have far-reaching implications for global businesses. These regulatory regimes have important implications for, and add complexity to, the planning and execution of M&A transactions.

US FDI Reviews Reach Record Levels

In the United States, the Committee on Foreign Investment in the United States ("CFIUS") reviews transactions involving foreign investors to determine whether the transactions pose a risk to US national security. CFIUS has broad authority to require changes to a transaction to address perceived national security concerns and also can recommend that the President block transactions—or even force divestitures after transactions have closed.

In 2018, the Foreign Investment Risk Review Modernization Act ("FIRRMA") expanded CFIUS's jurisdiction[1] and introduced a new type of filing: short-form declarations. As compared to long-form notices (which require detailed information about the transaction and the parties, including the personal identifier information of the board of directors and senior officers of parties in the foreign investor's ownership chain), declarations require only basic information about the parties and the transaction. Declarations are also assessed on a condensed timeline (30 days, once deemed complete) compared to notices (once deemed complete, notices are subject to a 45-day review period and, if necessary, a 45-day investigation period).

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[1] FIRRMA's changes included an expansion of CFIUS's jurisdiction to cover certain non-controlling transactions, requiring mandatory filings for certain transactions involving sensitive "TID U.S. Businesses" (dealing in Critical Technologies, Covered Investment Critical Infrastructure, and Sensitive Personal Data) and providing CFIUS with authority to review transactions involving real estate near sensitive military bases and government facilities.

Regulations to implement FIRRMA were finalized in 2020, and CFIUS activity has climbed to record highs since. In 2021 (the most recent year for which data is available and the first full calendar year following FIRRMA implementation), CFIUS reviewed 164 declarations and a record 272 notices, an increase of almost 15 percent over the previous annual high.

Even with FIRRMA's implementation, CFIUS continues to sharpen its focus and address new potential risks resulting from foreign investment. In September 2022, President Biden issued an executive order to provide detail and expand on the factors that CFIUS must use to evaluate foreign investments.[2]

Non-US FDI Regimes Have Grown and Expanded Their Reach

Outside of the United States, FDI has become an increased area of focus as well, whether through the introduction of new regimes or the tightening of existing rules.

The European Commission ("Commission") introduced an FDI screening mechanism, which became operative in October 2020. This mechanism provides a framework under which the member state authorities of the European Union can notify other member states and the Commission when certain transactions raise the risk of being likely to affect security or public order in their territory (and possibly territories of their member states). While not an additional review or investigation tool of the Commission, the mechanism does facilitate the exchange of information between the authorities and provides the opportunity to raise questions on ongoing proceedings. This mechanism can apply to all investments from non-EU investors.

The newly-implemented FDI regime in the United Kingdom, the National Security and Investment Act 2021 (the "NSI Act"), creates a broad investment screening mechanism as of its entry into force in January 2022. The NSI Act applies to transactions that give a foreign acquirer control over entities that are active in the United Kingdom or supply goods or services to persons in the United Kingdom. Importantly for investors, the NSI Act requires mandatory notifications for transactions that fall within the scope of 17 defined key sectors, including, Artificial Intelligence, Communications, Computing Hardware, Data Infrastructure, Defense, Energy, Suppliers to the Emergency Services, Synthetic Biology and Transport, among others. Similar to CFIUS, the NSI Act provides authorities with the power to block, impose conditions on, delay the closing of, or unwind transactions.

The United Kingdom is not the only non-US jurisdiction that has tightened its rules recently. Amendments to German foreign trade laws have widened the scope of voluntary and mandatory notifications. Broadly speaking, notifications are mandatory if they relate to the defense, IT security, critical infrastructure or other national security-related areas. Depending on the sector of the target, the acquisition of as little as a 10-percent ownership interest can trigger mandatory filing obligations. The German authority can prohibit a transaction or order conditions.

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[2] In particular, this executive order directed CFIUS to focus on: the resiliency of critical supply chains and the vulnerabilities to supply disruptions that may occur as a result of foreign investments; whether a transaction involves manufacturing capabilities, services, critical mineral resources, or technologies that are fundamental to US technological leadership; aggregate industry investment trends (i.e. the cumulative national security effects over time of a series of investments in the same or related business or sectors); the cybersecurity risks posed by an investment and the effects of these risks on national security; and the effects of a potential investment on the sensitive personal data of US persons.

Foreign investment rules in Australia have been similarly strengthened. Mandatory pre-closing filings are required in many circumstances—for example, if the target is a "national security business," a category which includes businesses involved in or connected with critical infrastructure assets, the telecommunications sector and the defense sector and its supply chains. Acquisitions of an interest of only 10 percent can trigger a mandatory filing, and there are plans to broaden the scope of the mandatory filing requirements to include 11 additional sectors, including communications, data storage and processing, higher education and research, healthcare and medical products. The Australian authority can object to a transaction or impose conditions.

New Zealand's FDI screening regime, which has been in place for several years, was expanded in 2021 to include additional investments involving strategically important businesses. Additionally, in Canada, there are plans to change the existing FDI regime—which allows for post-closing submissions—to one that includes a mandatory pre-closing filing requirement.

FDI Reviews and Blocked or Changed Transactions

The power of CFIUS and other FDI authorities to change or block transactions is not merely theoretical. In the United States, there have been a number of recent, well-publicized transactions that were blocked or abandoned due to CFIUS concerns, including nine transactions in 2021 that were abandoned by the parties following notification from CFIUS that it was unable to identify mitigation measures that would resolve its security concerns, or a proposal by CFIUS of mitigation measures that the parties chose not to accept. For example:

- In December 2022, CFIUS completed its review of a proposed $700 million investment by a Chinese company to build a corn milling project in Grand Forks, ND, approximately 12 miles from Grand Forks Air Force Base. While CFIUS ultimately determined that it did not have jurisdiction to review the investment, apparently because it did not involve an existing "US business" and the Grand Forks Air Force Base was not among the list of designated sensitive facilities, the public controversy generated by the project and the national security review proved overwhelming; in early February 2023, the Grand Forks city council voted to cancel the project due to national security concerns.
- In December 2021, a Chinese private equity firm and Magnachip Semiconductor, Ltd., a South Korean semiconductor company, announced that they were abandoning their planned merger due to indications that CFIUS would refer it to the President to be blocked. CFIUS's actions in this case were particularly notable in light of the company's relatively small nexus to the United States. While none of their employees, tangible assets, or sales activities were located in the United States, the transaction did involve a US business entity, and the company was listed on the New York Stock Exchange, which provided CFIUS with the jurisdictional hook needed to effectively block the transaction.

Short of blocking a transaction, CFIUS has the authority to require broad mitigation to address national security concerns, including by prohibiting the sharing of technical information; limiting access to technology, systems, facilities, or sensitive information; requiring the appointment of CFIUS-approved security officers; limiting physical visits to facilities; requiring security protocols to ensure product integrity; requiring supply assurance agreements; and requiring the use of only authorized vendors by US businesses.

In recent years, CFIUS has utilized its mitigation authority liberally—even in instances involving foreign investors from countries allied with the United States. In 2021, CFIUS required mitigation in response to approximately 11-percent of the notices it reviewed. CFIUS has used its mitigation power to address perceived vulnerabilities in US businesses, including a marked increase following high profile cyberattacks on critical infrastructure (e.g. the Colonial Pipeline attack) and government systems (e.g. the SolarWinds attack). In a number of instances, CFIUS has required mitigation regardless of the country of origin of the foreign investor. Such mitigation typically involves transactions with *per se* sensitive US businesses or government infrastructure or perceived threat vectors thereto.

There have been several notable blocked transactions outside the United States as well, including five transactions in the United Kingdom since the NSI Act was enacted. Examples include:

- In November 2022, the UK government required the divestment of the United Kingdom's largest semiconductor facility, Newport Wafer Fab, which had been acquired by China-backed Nexperia.
- In December 2020, the German government prohibited the acquisition of German company IMST GmbH, Kamp-Lintfort ("IMST") by a Chinese investor. IMST is a telecommunication technology provider, which was considered to be a strategic company due to its technology-driven business, robust R&D activities and R&D cooperation with other companies in the field of R&D, the amount of public funding it had received and the target's military nexus, alongside the acquirer's activities in China and the support it provides to Chinese defense sector.
- In December 2022, the UK government ordered the divestiture of Upp Corporation Ltd., a fiber broadband provider. The company had been acquired in January 2021 by L1T FM Holdings UK Ltd., a UK entity owned by investment manager LetterOne Core Investments. Although LetterOne is a Luxembourg entity, its ultimate owners include sanctioned Russian individuals.

Like CFIUS, there are non-US FDI authorities using mitigation to address perceived threats. Since the NSI Act was enacted, the United Kingdom has imposed conditions on nine deals. Recently, the United Kingdom cleared the Inmarsat/Viasat transaction—which involved a US investor—on the condition that information protection protocols be introduced and with a commitment to ensure that both parties continue to provide strategic capabilities to the UK government.

Governments Consider Potential Outbound Investment Review

In addition to CFIUS's record activity, US policymakers are also considering an outbound investment review mechanism. In March 2023, the Departments of Commerce and Treasury each issued reports on the status of their work to develop such a mechanism. These reports came following activity, including formal hearings, on the issue by congressional lawmakers in the previous few months. According to the reports, an outbound review mechanism is likely to focus on investments in certain countries of concern involving military or dual-use technologies and advanced technologies that are critical to US national security. Public reporting indicates that an executive order implementing the review mechanism is expected in the coming months.

Additionally, the European Commission has stated in its work program for 2023 (published in October 2022) that they will examine whether additional tools are necessary in respect of outbound strategic investment controls. No further information on the nature of the tools has been published yet, but it seems likely that these will be aimed at protecting national security interests and potentially relate to protecting against engaging in or supporting human rights violations.

Impact of FDI on Deal Planning and Execution

The proliferation of FDI regimes and reviews has important implications for M&A planning and execution. At the outset of transaction planning, it is important to identify the jurisdictions where an FDI filing is possible so that FDI reviews can be factored into how potential bidders are selected and viewed, the potential for extended deal timelines and deal certainty. Filing thresholds and the definition of sensitive industries vary by jurisdiction, as does the potential for a blocked deal or required mitigation, often requiring local counsel to be involved at an early stage of the transaction so that the risks are well understood. Where a filing is voluntary rather than mandatory, a seller may push the buyer to accept the risk of not filing to enhance closing certainty and speed. In any event, careful attention must be given to the covenants relating to the parties' respective efforts to secure FDI approvals (including whether a buyer will accept divestitures or other mitigation remedies) and the consequences of failure to get a required approval (such as a termination fee or a carve out of a problematic jurisdiction). With the right planning and preparation, buyers and sellers should be well positioned to negotiate the relevant contractual provisions governing the FDI filing and review process applicable to the transaction.

The New Congressional Select Committee on Economic Competition with China

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On January 10, 2023, the United States House of Representatives approved by a vote of 365-65 a resolution to establish the Select Committee on the Strategic Competition Between the United States and the Chinese Communist Party (the "Select Committee"). The Select Committee was established due to bipartisan concerns in Congress about China's rising economic threat to the United States. The Select Committee, composed of 16 members—nine Republicans and seven Democrats, has a statutory mission to examine "the status of the Chinese Communist Party's economic, technological, and security progress and its competition with the United States." The Select Committee is authorized to conduct investigations and issue policy recommendations. While it does not have any legislative jurisdiction and, therefore, is not authorized to draft and approve bills or resolutions, the Select Committee's policy recommendations are likely to be very influential and could set the stage for further legislative action by Congress. For this reason, it is critical for directors and officers of US multinational companies, as well as their legal advisors and cross-border deal makers, to understand the priorities of the Select Committee and to consider the Select Committee's policy recommendations when assessing transaction closing risk as well as company strategy.

The Select Committee's Role & Priorities

Representatives Mike Gallagher (R-WI) and Raja Krishnamoorthi (D-IL) respectively, serve as Chairman and Ranking Member of the Select Committee, a pairing which signaled both political parties' interests in having the Select Committee fulfill its statutory mission. Chair Gallagher and Ranking Member Krishnamoorthi, who had previously worked together on legislation regulating TikTok's use in the United States, set the tone for bipartisan cooperation early by identifying areas where they expect to find common ground on policy and legislation matters. Further, other members assigned to the Select Committee have released statements indicating that they will seek to work across the aisle.

Chair Gallagher has stated that his priorities will be to "[r]estore supply chains and end critical economic dependencies on China, [s]trengthen the military, [e]nd the CCP's theft of American personal data and intellectual property, and [c]ontrast the CCP's techno-totalitarian state with the values of the Free World." The Select Committee has a two-year authorization, so it will seek to issue its recommendations by the end of 2024.

The Select Committee's First Hearing

On February 28, 2023, the Select Committee held its first hearing, titled "The Chinese Communist Party's Threat to America." The witnesses for the hearing featured two former Trump administration officials, National Security Advisor H.R. McMaster and Deputy National Security Advisor Matthew Pottinger, as well as Tong Yi, a Chinese human rights advocate and former Secretary to a prominent Chinese dissident, and Scott Paul, President of the Alliance for American Manufacturing. Each of the witnesses sharply criticized China's economic policies as unfair and contrary to global trading rules and urged the Congress to take steps to significantly reduce the United States' dependence on trade with China.

The Committee members' questions at the hearing focused on a range of topics—from the Chinese government's motivations to compete with the United States, to trade and investment issues. With respect to trade issues, Mr. Paul stated that "I think a trade enforcement strategy is key, but I think a domestic competitiveness agenda is also key, and that requires public investment, that requires attention to our infrastructure, to our workplace, to make sure that we're not only the leaders in innovation, but we're the leaders in production again." Specifically, he called for more restrictions akin to recently implemented semiconductor technology export controls, enforcement of the Uyghur Forced Labor Prevention Act, building on the CHIPS and Science Act and other domestic manufacturing incentive programs for critical technologies, the screening of outbound investments to China and tightening the review process for the Committee on Foreign Investment in the United States (CFIUS), revising trade remedy laws through legislation like the Leveling the Playing Field 2.0 Act, and revoking normal trade relations with China. In response to questions from Congresswoman Mikie Sherrill (D-NJ) on how to reduce Chinese intellectual property theft, Mr. Paul noted that efforts by Japan and the Netherlands to match US export restrictions on semiconductors can bring a "screeching halt" to Chinese semiconductor development.

General McMaster called for the blocking of transactions involving Chinese investors buying land near sensitive military installations. General McMaster also called on the United States to reimplement "portions of the [Trans-Pacific Partnership], especially… data standards, for example," in order to reassert US leadership in the Indo-Pacific. He noted that the United States should also pursue Trade Promotion Authority with Taiwan and Great Britain.

Financial services and investment issues also came up during the hearing. Mr. Pottinger criticized the inclusion of Chinese companies on major stock indices, saying that this allowed "more and more money… [to passively flow] from American pensioners, [and] endowment funds at universities, into these Chinese companies." He also called on the Treasury Department to expand restrictions on US investment in Chinese military companies, noting that Americans are banned from investing in only 68 Chinese military companies. Congressman Blaine Luetkemeyer (R-MO) focused his questions on asset managers' investments in China, calling on asset managers to "decouple our investments so that we can slow down their [Chinese companies'] rate of growth so they can't compete with us." Mr. Pottinger supported this approach, and added that, as long as legal restrictions on investment in China were clear, US companies are "quite law abiding" and would comply.

The Select Committee's Second Hearing

On March 23, 2023, the Select Committee held its second hearing, titled, "The Chinese Communist Party's Ongoing Uyghur Genocide." The witnesses were Ms. Gulbahar Haitiwaji, a concentration camp survivor and author of *How I Survived a Chinese "Reeducation" Camp: A Uyghur Woman's Story*; Ms. Qelbinur Sidik, a human rights advocate and concentration camp witness; Dr. Adrian Zenz, Senior Fellow and Director of

China Studies at the Victims of Communism Memorial Foundation; Mr. Nury Turkel, Chair of the United States Commission on International Religious Freedom; and Ms. Naomi Kikoler, Director of the Simon-Skjodt Center for the Prevention of Genocide at the United States Holocaust Museum.

The purpose of the hearing was to provide firsthand accounts of human rights abuses in the Xinjiang Uyghur Autonomous Region of China. However, Mr. Turkel, Ms. Kikoler, and Dr. Zenz called on the United States to fully implement Global Magnitsky sanctions against individuals and entities committing human rights violations in the Xinjiang Uyghur Autonomous Region, consistent with the Uyghur Forced Labor Prevention Act. Ms. Kikoler also urged the United States to create an independent investigative mechanism to document human rights abuses against Uyghurs, and use asylum law to protect Uyghurs fleeing China.

During the question and answer period, Chair Gallagher asked if pension funds and university endowments should enjoy tax exempt status if they invest in "companies that contribute to the [Uyghur] genocide," even passively. Mr. Turkel agreed with this approach. Congressman Luetkemeyer also asked a question about the role of asset managers in funding human rights abuses in the Uyghur region; the panel stated that these firms help raise funds for companies that perpetrate these abuses. Congressman Ro Khanna (D-CA) asked the panel to respond to the current status of implementation of the Uyghur Forced Labor Prevention Act. Mr. Turkel praised the Act's role in chilling US investment in China, though Ms. Kikoler said that more enforcement of the Act was needed.

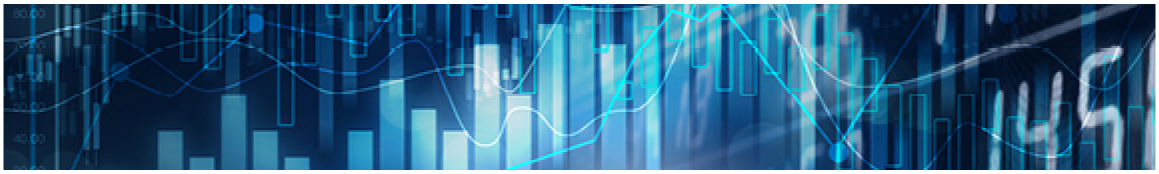
Additional Select Committee Activity

Chair Gallagher also has sought to draw attention to issues of interest to the Select Committee through a series of public statements and public appearances.

- Chair Gallagher and Ranking Member Krishnamoorthi issued a statement in response to reports that the Biden Administration will require ByteDance to fully divest its ownership of TikTok. They welcomed the announcement, but sought more details on if the move would remove all government investors in the company. They stated that "TikTok, under its current ownership and control structure, is an unmitigable threat to our national security and needs to be dealt with as such." They also urged the Biden Administration to codify the divestment of TikTok in legislation and set a precedent for "all TikToks to come."
- Chair Gallagher, along with Representative Carlos Gimenez (R-FL), visited the port of Miami and United States Southern Command to discuss security concerns around the use of Chinese-made infrastructure technology, like cranes, to surveil US ports and China's influence campaigns in South America.
- Gallagher visited Taiwan, where he met with President Tsai Ing-Wen and Vice President William Lai. Upon returning to the United States, Chair Gallagher stated that he wanted Americans to recognize the need "to arm Taiwan to the teeth to avoid a war."
- Chair Gallagher and other members of the Select Committee met with CEOs of major technology companies and Hollywood studios to discuss their business relationships with China and how the United States can outcompete China, particularly on AI technology.

Going Forward

The Select Committee is expected to continue to have regular hearings over the course of 2023 and 2024 designed to highlight US economic and national security concerns with respect to China. Since its inception earlier this year, the Select Committee has already been influential in the ongoing policy debate in the United States over what additional steps the nation should take to respond to the economic and national security challenges posed by China. Going forward, US multinational companies doing business in China, or seeking to do so, should carefully monitor the Select Committee's activities for insights on the future direction of US trade, investment, and national security policy towards China.



New FinCEN Ownership Reporting Requirement for Legal Entities

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United States legal entities and foreign legal entities that do business in the United States will need to comply with a new ownership reporting requirement (the "BOI Rule") from the US Financial Crimes Enforcement Network ("FinCEN"). While effectively all private companies are the focus of the rule, many partially owned subsidiaries and joint ventures of public companies and investment funds are implicated by the rule as well.

The BOI Rule takes effect on January 1, 2024, but pre-existing legal entities will have an additional year (i.e., until January 1, 2025) to become compliant. Below, we provide background regarding the BOI Rule and how it will be applied to public and private companies.

Background

The BOI Rule implements registration and reporting requirements of the Corporate Transparency Act ("CTA"), which was enacted into law as part of the National Defense Authorization Act ("NDAA") on January 1, 2021. The CTA and FinCEN's implementing regulations fit within a broader Biden Administration strategy to combat financial crimes, which we discussed in greater detail in our Legal Update, "First-Ever US Strategy on Countering Corruption Globally: Key Takeaways for Corporations to Match Enforcement's Increasingly Global, Integrated and Holistic Approach". The CTA requires a broad array of legal entities, both domestic and foreign, to register with FinCEN and disclose their ultimate beneficial owners. On April 5, 2021, FinCEN published an Advanced Notice of Proposed Rulemaking ("ANPRM"), the first step in the rulemaking process. On December 8, 2021, FinCEN published the Notice of Proposed Rulemaking ("NPRM" or "Proposed Rule") as the next step toward the implementation of the CTA. On September 30, 2022, FinCEN released the BOI Rule. For further detail on the ANPRM and the NPRM, see our Legal Updates "FinCEN Moves to Implement the Corporate Transparency Act" and "FinCEN Issues Proposed Rules Requiring Certain US and Non-US Legal Entities to Report Beneficial Ownership Information", respectively.

Key Elements of the BOI Rule

What Is a "reporting company"?

The CTA's filing requirements apply to "reporting companies," which include both domestic and foreign companies. Under the BOI Rule, a domestic reporting company includes a corporation, limited liability company or any other entity created by the filing of a document with a secretary of state or similar office, including, in certain circumstances, limited partnerships and business trusts. A foreign reporting company includes a corporation, limited liability company or other entity formed under the law of a foreign country that is registered to do business in any jurisdiction within the United States.

What Are "Exempt Entities"?

The CTA sets forth exemptions from the reporting requirements for certain US and foreign legal entities. The BOI Rule does not significantly diverge from the language of the CTA regarding exemptions. Generally, the categories of exempt entities cover entities that are heavily regulated and, therefore, have beneficial ownership information that is more readily available to US regulators, such as US banks, SEC-registered broker-dealers, SEC-registered investment companies and advisers, FinCEN-registered money services businesses, and insurance companies, among many others. All US public companies should also be excluded through the exemption for SEC reporting issuers (i.e., Section 12 or 15(d) filers). We discuss below the exemptions most relevant to corporate clients.

Large Operating Company Exemption

Under the BOI Rule, an entity is exempt from the reporting requirements if it is a large operating company, which is defined as an entity that (1) employs more than 20 employees on a full-time basis in the United States; (2) filed in the previous year federal income tax returns in the United States demonstrating more than $5 million in gross receipts or sales in the aggregate, including the receipts or sales of other entities owned by the entity and through which the entity operates; and (3) has an operating presence at a physical office within the United States. The BOI Rule clarifies what it means to employ someone on a full-time basis by referencing the US Internal Revenue Service's ("IRS") definition of a "full-time employee." For the tax filing prong, the relevant filing may be a US federal income tax or information return, including a parent company's consolidated return.

Subsidiary Exemption

With respect to the "subsidiary exemption," the BOI Rule states that entities (usually subsidiaries) that are owned or controlled by other exempt entities (which include most, but not all, exempt entities under the CTA) will themselves be exempt from the filing requirement. Notably, FinCEN interprets the statutory text as requiring an entity to be owned entirely by one or more specified exempt entities in order to qualify for this exemption, which may preclude joint ventures and entities subject to director qualifying share requirements from qualifying. Therefore, even if an entity is a subsidiary of a public company for certain purposes (e.g., accounting consolidation), it may not be a subsidiary for purposes of the BOI Rule and would need to comply with the rule's ownership reporting requirements.

Whose Information Must Be Reported?

The CTA requires the reporting company to submit to FinCEN information relating to each of its "beneficial owner(s)" and "company applicant(s)."

*Beneficial Owner***:** The CTA defines a "beneficial owner" as "an individual who, directly or indirectly, through any contract, arrangement, understanding, relationship, or otherwise—(i) exercises substantial control over the entity; or (ii) owns or controls not less than 25 percent of the ownership interests of the entity." As described below, the BOI Rule expands on the meaning of these terms.

Substantial Control

In order to clarify what it means to exercise "substantial control" over an entity, FinCEN identifies three indicia of substantial control in the NPRM: (1) service as a senior officer of a reporting company; (2) authority over the appointment or removal of any senior officer or dominant majority of the board of directors (or similar body) of a reporting company; and (3) direction, determination or decision of, or substantial influence over, important matters of a reporting company.

This interpretation greatly expands the universe of persons who must be reported to include many executives who may have no financial interest in the performance or assets of the reporting company. It also may be particularly burdensome for foreign companies subject to comprehensive privacy laws (e.g., EU General Data Protection Regulation or GDPR), which could be required to disclose the foreign residential addresses of executives.

Ownership or Control of Ownership Interests

The BOI Rule also clarifies what it means to "[own] or control not less than 25 percent of the ownership interests of the entity" by defining ownership interests (which may be held through trusts or similar arrangements), providing guidance on how to determine a 25 percent ownership interest (done by aggregating all of the individual's ownership interests in comparison to the undiluted ownership interests of the company) and explaining how an individual can "own or control" interests (which can be done directly or indirectly). Notably, "ownership interests" include all instruments that represent a capital interest in the reporting company or a right or interest in the value of the reporting company or its profits. This would include equity kickers and potentially could include other instruments with equity-like attributes, such as preferred shares.

*Company Applicant***:** In addition to beneficial owners, a reporting company is required to submit information regarding the "company applicant." For domestic reporting companies, the proposed rule defines a company applicant as an individual who files the document that forms the entity. For foreign reporting companies, a company applicant is the individual who files the document that first registers the entity to do business in the United States.

In both cases, anyone who directs or controls the person who files the relevant document would also be a company applicant. However, the BOI Rule provides that if an entity was formed prior to the effective date of the rule, then it has no requirement to report company applicants.

What Information Must Be Reported?

FinCEN requires the reporting company to provide its name, any alternative names through which it engages in business, its business street address, the jurisdiction of formation or registration and a unique identification number. With respect to beneficial owner and company applicant information ("BOI"), the reporting company must provide an individual's name, birthdate, residential or business address (depending on whether the person is a beneficial owner or certain kind of company applicant) and a unique identifying number from an "acceptable identification document" (and the image of such document).

FinCEN recognized in the NPRM that commenters urged it to collect information with respect to the reporting company's relationships with intermediate legal entities, its parents, subsidiaries, affiliates and beneficial owners. However, commenters did not identify the statutory authority for collection of such information. Therefore, while FinCEN welcomes further comments on this topic, it remains to be seen if FinCEN will add any additional reporting requirements in the final rule regarding a reporting company's relationship to its closely connected entities and individuals.

When Must Reports and Updates Be Filed By?

The effective date of the rule is January 1, 2024. For domestic and foreign reporting companies created or registered on or after the final regulation, the reporting company must file with FinCEN 30 calendar days after formation or registration. An entity formed or registered before the effective date of the final regulations is required to file its initial report no later than one year after the effective date of the regulation—January 1, 2025. The BOI Rule also aligns the reporting of updates or reporting of inaccuracies with the 30-calendar-day timeframe.

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