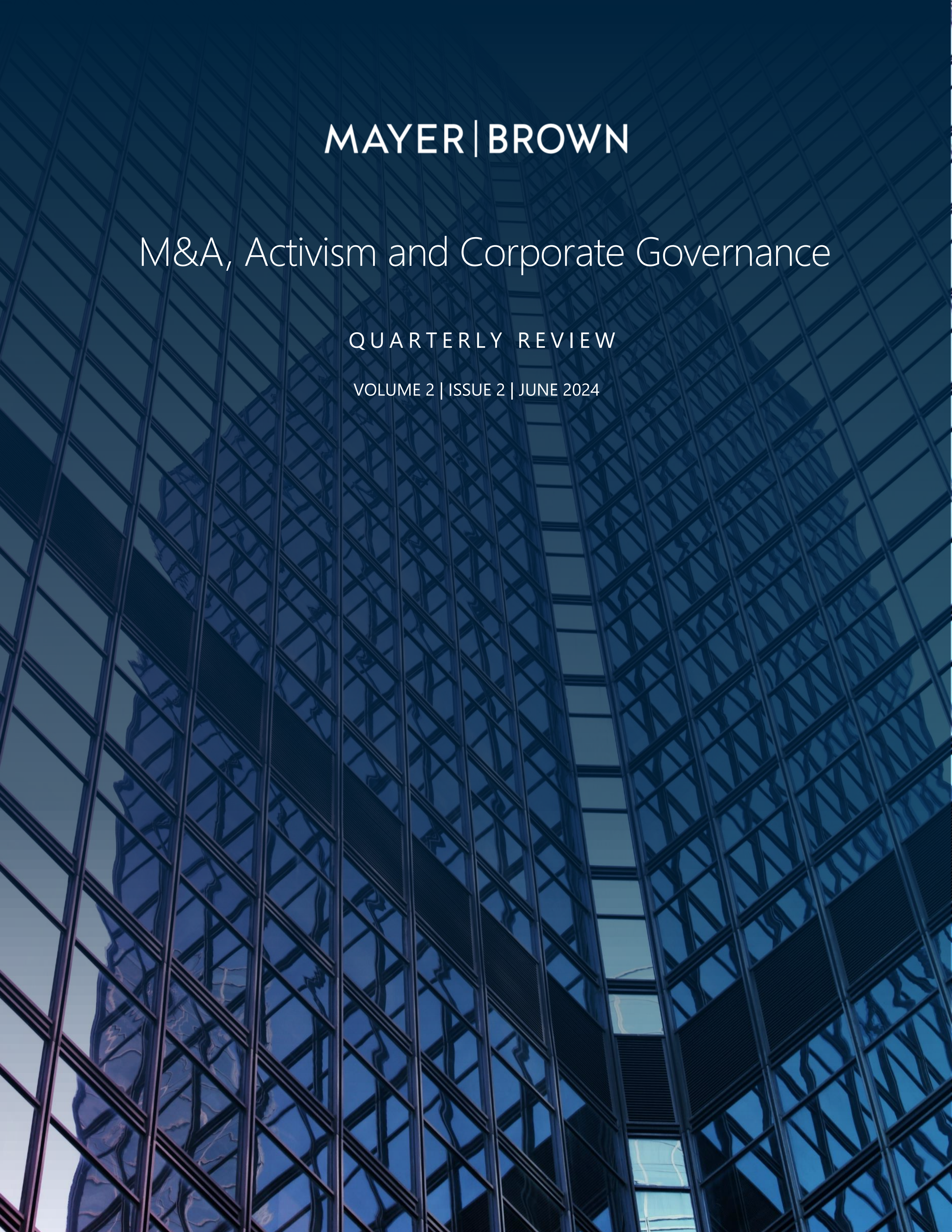

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Introduction

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

Disney's Victory in 2024 Proxy Contest: Lessons for Boards and Practitioners

By: Martha McGarry, Andrew Noreuil, Camila Panama and Alexander Dussault

On April 3, 2024, The Walt Disney Company ("Disney") successfully won a proxy contest launched by Nelson Peltz's Trian Fund Management LP ("Trian") and Blackwells Onshore I LLC and affiliates ("Blackwells") at its 2024 Annual Shareholders Meeting. The outcome of this high-profile contest offers several insights for boards and practitioners on how to prepare for and respond to activist challenges in today's corporate governance landscape. In this article, we highlight some of the key takeaways from Disney's 2024 Annual Meeting.

I. Universal proxy rules might make it harder for dissidents to win a board seat

Prior to the universal proxy rules going into effect, due to the use of separate proxy cards by the company and dissidents and the applicable proxy rules, it was common practice for dissident shareholders nominating a "short slate" of nominees to "round out" their slates by committing to vote any proxies they held for the company's nominees other than certain company nominees whose names were listed on the dissident's proxy card.[1] As a result, it was not possible for a shareholder to vote for certain company nominees if the shareholder used the dissident proxy card,[2] which ensured for the dissident that at least certain company nominees would not receive any votes for their election if a shareholder used the dissident's proxy card. Under the universal proxy rules, all nominees are required to be listed on each proxy card, so a shareholder's use of the dissident proxy card by itself would not guarantee that certain company nominees would not also receive votes from that shareholder. A shareholder voting for two out of two nominees of the dissident could properly complete a proxy card by voting for all but any two company nominees, so, if shareholders supportive of the dissident voted for company nominees across a greater number of company nominees than could be voted for on the dissident's proxy card under the previous proxy rules, there is the potential to reduce the likelihood that the dissident's nominees receive sufficient votes to be elected.

Under the plurality voting standard that applied in Disney's proxy contest, the nominees that received the greatest number of votes for their election would be elected to the available board seats.[3] Notwithstanding the historical practice of dissidents rounding out their slates by committing to vote for enough company nominees to equal the number of board seats up for election, the best strategy for a dissident is for shareholders to vote for all the dissident's nominees and not vote for any other nominees. This "undervote"

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[1] Under the proxy rules before the adoption of the universal proxy rules, a dissident could not list the names of the company nominees that it would vote for but it could list the names of the company nominees that it would not vote for. The number of company nominees that a dissident would not vote for was typically the same as the number of nominees that the dissident nominated on its short slate, thereby permitting a shareholder using the dissident proxy card to vote for a number of nominees equal to the number of board seats up for election (although a shareholder could always withhold authority to vote for any nominee that it specified on the completed proxy card).

[2] Similarly, if a shareholder used the company's proxy card, the shareholder could not vote for any of the dissident's nominees.

[3] Under plurality voting, "Withhold" votes do not affect the outcome of the election.

strategy would result in fewer votes for every company nominee, thereby making it easier for dissident nominees to be elected under a plurality voting standard. Nevertheless, Trian and Blackwells took different approaches in how they requested Disney shareholders to vote. Trian's voting recommendation was that shareholders vote for Trian's two nominees and withhold on two named Disney nominees (discussed below) and all Blackwells nominees. Trian stated that it made no voting recommendation regarding the other 10 Disney nominees, whom it referred to as "Acceptable Company Nominees".[4] Blackwells was more direct in its approach and asked that shareholders vote for only its three nominees and withhold on all Disney nominees and Trian nominees.

II. Universal proxy rules are bringing increased focus on the credentials and experience of all director nominees

Trian's proxy contest at Disney reflects the consistent strategy of dissident shareholders nominating a "short slate" and highlights the increased focus of companies, dissident shareholders and voting shareholders on the credentials and experience of individual nominees. Trian publicly targeted incumbent Disney directors Michael Froman and Maria Elena Lagomasino, advocating that Disney shareholders withhold votes from them and instead vote for Peltz himself and Disney's former Chief Financial Officer, James Rasulo. Trian's targeting of Lagomasino was rooted in her role as the chairperson of Disney's compensation committee, which, he argued, was responsible for having "overseen a number of misaligned compensation practices." With respect to Froman, Trian argued that he had no experience as a public company director outside of Disney and lacked experience in fields related to Disney's businesses. However, Rasulo, who had left Disney in 2015 and was touted by Trian for his previous CFO experience at Disney, was alleged by Disney to have an "outdated perspective" by being out of the company for too long and Peltz was alleged to have insufficient media experience. With each side combing through the experience and credentials of the other's candidates, though Trian was ultimately unsuccessful, Froman and Lagomasino received the lowest support of Disney's shareholders—of the 1,264,705,371 shares of Disney common stock represented at the 2024 Annual Meeting,[5] 1,041,678,945 (or ~82%) supported Froman and 748,599,867 (or ~59%) supported Lagomasino. By contrast, the closest other incumbent directors, Mark Parker and Derica Rice, were supported by holders of ~83% and ~86% of Disney shares, respectively. Trian's targeting of Froman and Lagomasino likely resulted in their receiving the least amount of support from shareholders, and, had Trian not targeted specific incumbent directors, shareholders may have withheld votes from other, varying Disney nominees. As the variation among the incumbent nominees that shareholders vote for increases, the likelihood for Trian's nominees to ultimately overtake any two particular Disney nominees would have decreased. This dynamic supports the trend in continued targeting by dissidents of individual incumbent nominees and was at play during Carl Icahn's proxy contest at Illumina, Inc. ("Illumina") in May 2023: Carl Icahn targeted three incumbent directors, Francis deSouza, Robert Epstein and John Thompson, and those three received the lowest amount of support of Illumina's nominees, resulting in Icahn securing one seat on Illumina's board.

This pattern of publicly targeting nominees and focusing on their credentials and experience highlights the importance of boards being mindful of the potential vulnerability of directors who may be perceived as "weaker" or "less qualified" by shareholders or whose performance in their roles at the company, such as the CEO or the chair of the compensation committee, is fairly subject to criticism. Boards should give thought to the credentials of the incumbent directors and consider how to best reflect their qualifications

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[4] Trian indicated that if a shareholder returned a signed Trian proxy card with no voting instruction for the election of directors, Trian would, among other things, vote Withhold for the Acceptable Company Nominees.
[5] Approximately 69% of Disney's outstanding shares were represented at the meeting.

and contributions in the proxy materials and communications, while distinguishing those of dissident nominees.

III. Boards should consider using a variety of creative tools to engage with their shareholders, including by well-executed use of videos or other media as well as use of endorsements by celebrity shareholders

Disney has a significant retail shareholder base, which accounted for 33.1% of its shares—which is higher than the average of 31.5% for publicly traded companies in 2023. Approximately 75% of Disney's retail shareholders backed the company's slate, which was in line with historic trends of retail shareholders supporting management's nominees. As a result, retail investors can be a valuable source of support for boards facing activist situations in the universal proxy rule era.

Disney engaged its retail investors by leveraging influential investors, such as George Lucas, who received 37.1 million shares of Disney stock as part of Disney's purchase of Lucasfilm in 2012 and who publicly endorsed Disney's board. Disney also used its website, www.votedisney.com, to provide updates on its progress towards the strategic plan it began implementing in the wake of Trian's first proxy contest in 2023 and by providing detailed instructions on how retail investors could vote at the 2024 Annual Meeting, including by leveraging its media resources to produce and advertise a video featuring Disney characters that instructs Disney shareholders on how to vote.[6] In this video, Disney highlighted that its shareholders should use the "white" proxy card, which has historically been used by the company, which Disney expressly reserved through an amendment to its bylaws.

These measures helped Disney to connect with its retail shareholders in a very real way while also showcasing its strength in creative media and filmmaking. While most companies and activists often establish a webpage devoted to all things relevant to the proxy contest, putting out an animated video that educates shareholders on the voting process and reinforces the reasons why shareholders should have trust and confidence in the board and management is something novel coming out of the Disney-Trian proxy contest. As retail investment continues to grow, boards would be well served to continually consider ways for the company to further bolster its ties to retail shareholders and leverage the company's strengths and history, whether through communications or governance procedural measures.

IV. Index funds maintain heavy influence on proxy contest outcomes and proxy advisors still play a key role in the universal proxy rule era

Index funds are among the largest and most influential institutional investors in the market, and their voting decisions continue to have a significant impact on the outcome of proxy contests. In Disney's case, Blackrock and Vanguard, which held ~4.24% and ~7.84% of Disney's shares, respectively, both supported Disney's slate, signaling to other institutional investors that a collective of over 12% of Disney's shares would back the board's nominees.

In addition, the continued influence of the two major proxy advisors, Institutional Shareholder Services (ISS) and Glass Lewis, remains front and center. While Glass Lewis endorsed the entirety of management's slate, ISS split its recommendation and advised shareholders to vote for Trian's Nelson Peltz and withhold from Disney's Maria Elena Lagomasino, citing her role as the compensation committee chair and membership on the governance nominating committee with respect to Disney's historic executive compensation practices and leadership succession planning. This split recommendation likely contributed to the relatively close vote margin between Peltz and Lagomasino as some institutional investors may have followed ISS's

[6] https://d23.com/who-is-ludwig-von-drake-video/how-to-vote_compressed/

guidance and used the universal proxy card to vote for a mix of nominees. This is not the first time that ISS and Glass Lewis have issued split recommendations; they both split recommendations in Icahn's contest at Illumina and ISS split its recommendation in Land & Buildings' proxy contest at Apartment Investment and Management Co. In those contests, each of the dissidents ultimately gained one board seat but did not succeed in having all of their respective nominees elected.

In the universal proxy rule era, proxy advisors are able to focus their analysis and recommendations with further specificity on a per-nominee basis. By implementing a strategy of self-assessment in consideration of the criteria and methodology that proxy advisors use to evaluate board nominees, boards will be better positioned to address any potential concerns or criticisms that proxy advisors may raise in their reports. Keeping in mind the continued influence of index funds and their view on proxy advisor recommendations should be an important component of this strategy to enable boards to have meaningful and appropriate conversations with large institutional shareholders to find a path forward and secure support when a proxy advisor's recommendation is either split or in support of a dissident shareholder.

V. Acknowledgment of a dissident shareholder's views and implementation of initiatives to address them before a proxy contest can preempt activist concerns

Disney's victory in the proxy contest also reflects its proactive and preemptive response to Trian's calls for change. Disney announced a series of initiatives in the autumn of 2023 to address the issues that Trian had raised in its 2023 activism campaign, such as increasing streaming profitability, improving the output and economics of film studios, and increasing profitability of Disney's Experiences business. Many of these initiatives had parallels to those that Trian had suggested and may have blunted some of the criticism coming from Trian in the 2024 campaign.

Disney took the proactive approach of implementing changes *prior* to the annual shareholders' meeting to address in some form certain of Trian's criticisms. The company commenced certain operational initiatives that resulted in positive financial results during the financial quarter immediately preceding the 2024 Annual Meeting. While boards may not always have the benefit of knowing the basis for a dissident's misgivings prior to the launch of a proxy contest or have the time or resources to implement strategic changes, Disney's success highlights the value boards can achieve by regularly meeting with shareholders (including with shareholders who are known to take activist positions) to hear-out their views, and proactively implementing changes to address concerns, as the board deems appropriate. Boards that are open to receiving appropriate input from shareholders may leverage this information to preempt potential activists by building a track record and/or financial results that address the issues raised by a potential activist, which shows a willingness by incumbent directors to consider and seek to address the concerns of shareholders.

VI. While succession planning is an important priority, having a strong CEO in place is critical to instilling shareholder confidence

Trian's proxy contest placed heavy emphasis on the succession planning at Disney, which had been disrupted by the COVID-19 pandemic and the termination of Bob Chapek as CEO in 2022, which led to the return of Bob Iger as CEO. Trian questioned Iger's role and future at Disney, and Trian argued that Disney needed a clear and transparent succession plan to ensure stability and continuity. Disney acknowledged that succession planning was the board's top priority, and that it was working on finding and developing the next generation of leaders for the company.

Succession planning is a critical issue for boards to address, not only to blunt activist criticism, but also to ensure the long-term success and stability of the company. However, Trian's loss at the 2024 Annual Meeting underscores that a lack of a clearly announced succession plan is not fatal if the current executive leadership is viewed as strong and capable. Iger remains synonymous with the modern success of Disney, grounded in deep experience in the media industry, compared to Peltz's relative lack of industry experience. The positive financial results released by Disney in the run-up to the 2024 Annual Meeting may also have reinforced shareholder confidence in Iger, reflected in their support for Disney's slate of nominees. Further, Disney is far from the only company to struggle with succession planning and continuity of executive leadership. Several other companies have, in recent years, waived their mandatory retirement ages for their existing CEOs as they look to take a thoughtful and measured approach to leadership transition. For example, in 2023, Chevron waived its mandatory retirement age for CEO Mike Wirth, while Caterpillar Inc. and Target Corp. did the same for Jim Umpleby and Brian Cornell, respectively, in 2022.

Succession planning can be challenging, especially in times of uncertainty and potential activist activity, but boards should be mindful of the potential costs and risks of mismanaging or accelerating succession, including losing talent, undermining credibility, or creating uncertainty. By striving to establish a robust and transparent succession process that involves regular evaluation, communication, and development of potential candidates, boards can avoid triggering dissident misgivings while touting the experience of current executives and potential successor candidates.

Conclusion

Disney's success at its 2024 Annual Meeting highlights the continued focus on the credentials and experience of nominees, the impact of a single ballot listing all nominees, the effectiveness of communication and connection with all types of shareholders, the ever-present influence of proxy advisors and the criteria they use in making recommendations, and the importance of strong executive leadership in securing shareholder support. As boards navigate future challenges, the lessons from Disney's victory provide greater clarity on how shareholder activism and corporate governance dynamics will continue to evolve in the era of the universal proxy rules.

DGCL Amendments Proposed to Address Recent Delaware Court of Chancery Decisions Affecting Stockholder Agreements, Board Approvals of Merger Agreements and Damages for Lost Stockholder Premiums

By: Martha McGarry, Andrew Noreuil, Camila Panama and Dustin Cooper

Three recent decisions from the Delaware Court of Chancery (the "Court") have upended long-standing market practice related to, among other matters, stockholder agreements, board approvals of merger agreements and the availability of damages for lost stockholder premiums following a failed deal. The decisions carried a common theme, standing in favor of strict statutory interpretation over generally accepted market practice, with one decision noting that "[w]hen market practice meets a statute, the statute prevails." Delaware's Council of the Corporation Law Section of the Delaware State Bar Association, which is responsible for proposing amendments to the Delaware General Corporation Law ("DGCL"), responded swiftly by drafting proposed amendments to the DGCL that would abrogate the Court's decisions. After some revision, on June 20, 2024, the Delaware General Assembly passed a bill to enact the proposed amendments, which, as of this writing, is awaiting the signature of Governor John Carney. Below we provide an overview of the three cases and the amendments to the DGCL that have been proposed in response to those decisions.

The Cases and Related Proposed Legislation

West Palm Beach Firefighters' Pension Fund v. Moelis & Co., 2024 WL 747180 (Del. Ch. Feb. 23, 2024)

The plaintiff challenged the facial validity of various provisions in a stockholder agreement between a public corporation and its founder. The agreement in question provided the founder veto rights over various corporate actions and over the composition of the corporation's board of directors and board committees. The Court granted partial summary judgment in favor of the plaintiff, holding that most of the challenged provisions in the agreement were facially invalid under the DGCL because they restricted the authority of the board of directors to manage the business and affairs of the corporation. The Court found that requiring the board of directors to obtain the founder's prior consent for significant actions effectively delegated managerial authority to the founder, and restricted the board of directors' independent judgment.

Though the rights granted to the founder in *Moelis* were more generous than typically seen, it is common practice for a controlling stockholder to have powers over certain aspects of the running of a corporation, effectively delegating certain decisions to such stockholder. The DGCL amendments in response to *Moelis* add new Section 122(18), which expressly authorizes a corporation to enter into contracts with its stockholders and beneficial owners containing the types of consent rights at issue in *Moelis*, in exchange for minimum consideration determined by the board of directors. The amendments allow for contracts pursuant to which the approval or consent of a stockholder, or stockholders, is required before the corporation may take certain actions. The proposal also codifies the long-standing market practice of corporations agreeing to take or refrain from taking certain corporate actions, providing stockholders or beneficial owners veto rights over certain corporate decisions, and agreeing to support for election director nominees designated by one or more stockholders and appoint stockholder-designated directors to committees of the board.

Sjunde AP-Fonden v. Activision Blizzard, Inc., 2024 WL 863290 (Del. Ch. Feb. 29, 2024)

In January 2022, Activision, Inc.'s ("Activision") board met and approved a draft merger agreement in connection with Activision's acquisition by Microsoft Corporation. The full board did not review or approve any subsequent version of the merger agreement, including a final and complete execution version. The merger was later approved by Activision's stockholders, with more than 98% of stockholders voting in favor of the transaction. The plaintiff alleged that the board approval process violated the DGCL. The draft agreement approved by the board did not yet contain (as is typical in complex and confidential transactions) certain key items, including: (i) the company disclosure letter and disclosure schedules, (ii) the surviving corporation's certificate of incorporation, and (iii) the consideration amount and Activision's name as the target (placeholders were included for both), all of which such items the Court found needed to be included "at a bare minimum". The draft agreement also did not address an open issue of dividends Activision would be permitted to pay while the merger was awaiting regulatory approval. The board had delegated this issue to a board committee, which negotiated a resolution. The Court found the delegation improper. Additionally, as is customary practice, the notice Activision sent to its stockholders in connection with the special stockholders' meeting to vote on the transaction included an agenda item for a vote to adopt the merger agreement and attached a proxy statement, which contained an extensive summary of the merger agreement and a copy of the agreement itself.

In its decision on defendants' motion to dismiss, the Court acknowledged it is common practice to present the target board with an incomplete (but "near final") version of a merger agreement for approval, but it concluded that market norms do not supersede statutory terms. The Court went on to find that, at a minimum, the DGCL required that the draft agreement approved by the board be essentially complete and concluded that the draft agreement approved by the Activision board was not. The Court also found the stockholder notice to be defective because (i) the merger agreement annexed to the proxy statement did not include a copy of the surviving corporation's certificate of incorporation, and (ii) while the proxy statement contained a summary of the merger agreement, the notice did not. Numerous amendments to the DGCL have been proposed to ameliorate the practice issues implicated by the *Activision* decision, including by providing, as is common practice, a board of directors the authority to delegate document finalization to a corporation's advisors following agreement on material terms.

- New Section 147 allows a board of directors to approve any agreement, instrument or document (i.e., the amendment includes more than just merger agreements, which was the primary issue in *Activision*) that requires board approval under the DGCL in either final form or "substantially final" form.
- Pursuant to new Section 268(a), if a merger agreement provides that all shares of capital stock of the constituent corporation issued and outstanding immediately before a merger are converted into or exchanged for cash, property, rights or securities (other than stock of the surviving corporation), then the merger agreement approved by the board does not require any provision regarding the certificate of incorporation of the surviving corporation in order for the agreement to be considered to be in final form or substantially final form.

- New Section 268(b) provides that, unless otherwise provided in the merger agreement, a disclosure letter or disclosure schedules or any similar documents delivered in connection with the agreement that modify, qualify, supplement or make exceptions to representations, warranties, covenants or conditions in such agreement will not be deemed part of the agreement for purposes of the DGCL.
- Section 232 is being amended to provide that materials included with or attached to a notice to stockholders are deemed part of the notice for purposes of compliance with the DGCL's notice procedures.

Crispo v. Musk, 304 A.3d 567 (Del. Ch. Oct. 31, 2023)

Elon Musk agreed to acquire Twitter, Inc. ("Twitter") in April 2022. Musk's counsel subsequently sent a letter to Twitter purporting to terminate the merger agreement. Twitter and certain of its stockholders sued for, among other things, specific performance of the agreement, and the merger later closed. Following the closing, one of Twitter's stockholders that had filed suit attempted to claim partial credit for the deal's consummation and petitioned the Court for a mootness fee alleging that his suit had been meritorious when filed on the basis of a provision in the merger agreement providing that in the event of breach, the buyer would be liable for "lost stockholder premiums." Under the doctrine set forth in *Consolidated Edison, Inc. v. Northeast Utilities*[7], legal practitioners generally operated under the premise that an agreement could provide a target corporation the ability to claim damages for lost stockholder premiums by specifying in the agreement that the measure of target's damages would include lost stockholder premiums. The ability to hold a buyer liable for lost stockholder premiums in the event of its breach of the merger agreement is an important right for a target corporation to incentivize buyers to close transactions. The Court held, however, that the lost premium provision was unenforceable because the lost stockholder premiums were amounts meant to be received by Twitter stockholders (not Twitter), and a contract party cannot recover damages for consideration it did not expect to receive in the transaction (as such amounts would be considered unenforceable penalties).

Proposed new Section 261(a)(1) provides that parties to a merger agreement may specify the penalties or consequences for a party's failure to perform its obligations. Such penalties or consequences may include payments to the other party if a merger does not become effective, including damages based on the lost premium that stockholders would be entitled to receive if the merger had been consummated. In addition, new Section 261(a)(2) provides that parties may appoint one or more persons to serve as representative(s) of the stockholders, and to delegate to such representative(s) the authority to enforce the stockholders' rights under the agreement (e.g., to receive payments).

Effective Date of Amendments

If the DGCL amendments are enacted, they will become effective on August 1, 2024. The amendments will apply to (i) all contracts made by a corporation; (ii) all agreements, instruments or documents approved by the board of directors; and (iii) all merger and consolidation agreements entered into by a corporation, in each case whether approved or entered into on or before August 1, 2024. The amendments will not apply to or affect any civil action or proceeding completed or pending on or before such date (to which the law predating the amendments will apply).

[7] 426 F.3d 524 (2d Cir. 2005).

Spotlight on Delaware

The amendments, particularly those that address the *Moelis* decision, have not been without controversy. For example, a group of over 50 law professors submitted a letter to the Delaware legislature in opposition to the DGCL amendments, arguing that the "appropriate response to the *Moelis* decision is to allow the appellate process to proceed to the Delaware Supreme Court". Others, however, have praised the Delaware legislators and the Council of the Corporation Law Section of the Delaware State Bar Association, for helping to reestablish the clarity and predictability that corporations have come to expect from the Delaware legal framework. With recent events such as Tesla shareholders voting to move the company's place of incorporation out of Delaware, there is added spotlight on how the Delaware legislature and judiciary will proceed.

US State Insurance Regulatory Scrutiny of Private Equity Investors in the Insurance Industry

By: David W. Alberts, Lawrence R. Hamilton and Vikram Sidhu

Private equity ("PE") firms have been increasingly active in the US insurance industry, attracted by the opportunity to access long-term capital and manage large pools of assets. However, this trend has also raised concerns among US state insurance regulators, who are tasked with, among other things, protecting the interests of policyholders and ensuring the financial stability of insurers. In recent years, US state insurance regulators have adopted new regulatory guidance and undertaken new regulatory initiatives to address the perceived risks posed by PE investors in insurance, especially in relation to the PE investors' investment strategies and group structures for ownership of insurance businesses.

PE Investments in Insurance

According to the National Association of Insurance Commissioners ("NAIC"),[8] "[s]ince the financial crisis of 2008, PE firms have become some of the most active participants in insurance sector merger and acquisition (M&A) activity."[9] Although PE investors look for opportunities broadly across the insurance industry, they often seek to acquire insurers that have long-term liabilities, such as annuities and life insurance, and that generate stable cash flows from premiums. These features allow PE firms to deploy the insurers' assets in funds and investments managed by the PE firm and its affiliates, especially assets that offer higher returns than traditional fixed income investments.

Prior Regulatory Scrutiny

In the mid-2010s, the NAIC and the New York Department of Financial Services ("DFS") reacted to several high-profile PE acquisitions of insurance companies by adopting new guidance to be used by state insurance regulators when deciding whether to approve acquisitions of insurance companies.[10] That guidance was designed to help regulators assess who is trying to acquire control of an insurer, what the plans are for the insurer after gaining control and whether the acquirer has sufficient capital to support the insurer's operations and risks. The guidance included examples of stipulations—both limited-in-time and ongoing—that regulators could impose on PE investors both when approving acquisitions and in ongoing surveillance of PE-owned insurers. For example, regulators could require PE-owned insurers to maintain higher capital levels, to limit their exposure to certain asset classes and to provide more information and transparency about their group structures and affiliates. Consistent with those goals, regulators have continued to closely monitor PE-owned insurers using such existing tools as the Form A application for

[8] The NAIC is not a regulator itself. Instead, the NAIC is the standard-setting and regulatory support organization created and governed by the insurance regulators from the 50 states, the District of Columbia and the five US territories.

[9] https://content.naic.org/cipr-topics/private-equity.

[10] Under the US states' insurance laws, any individual or entity that seeks to "control" an insurer (for which there is a statutory presumption at 10% or greater ownership, directly or indirectly, of voting securities of an insurer) must obtain approval for such acquisition of control from the domiciliary state insurance regulator of the insurer by filing an application that is typically referred to as the "Form A." However, an investor can rebut the presumption of control by filing a "disclaimer" of control with the insurer's domiciliary state insurance regulator.

acquisition of control approval process, restrictions and requirements on dividends from insurers and the risk-based capital ("RBC") requirements.[11]

Initially, regulators were concerned that PE firms would have a short-term and opportunistic approach to the insurance business and at worst would strip insurers of their capital and assets, leaving them unable to meet their long-term obligations to policyholders. However, that concern has not been borne out by the evidence, as PE firms have not sought to exit the industry quickly or recklessly. PE investors in insurance have run their insurance businesses in accordance with the broad range of insurance laws and regulations—including those governing investments, affiliate transactions and holding companies—that apply to all insurers.

Evolution of Regulators' Perspective

The concerns of regulators regarding PE-owned insurers have evolved in recent years. More recently, regulators have been concerned that their existing regulatory tools and prior guidance may not be adequate to capture the full extent and complexity of the regulatory risks they perceive to be associated with PE-owned insurers, including with respect to sophisticated and innovative use of offshore reinsurers, structured investments and sidecar vehicles. While these new business and financial developments allow PE firms to maximize capital efficiency and returns for the insurance businesses in which they invest, such developments also introduce new challenges and uncertainties for regulators, such as how to value and account for the assets underlying these transactions, how to identify and monitor the role of affiliates and third parties in these transactions and how to ensure that the insurers have adequate reserves and liquidity to meet their liabilities.

To address these challenges, the NAIC has initiated a new wave of regulatory initiatives relating to PE-owned insurers. In 2021, the NAIC's Financial Stability (E) Task Force ("FSTF") and Macroprudential (E) Working Group developed a document outlining 13 "List of MWG Considerations - PE Related and Other (naic.org)"[12] that they believed needed to be addressed in relation to PE-owned insurers. The document was adopted by the FSTF and its parent Financial Condition (E) Committee in 2022, and became the basis for referrals to various other NAIC working groups and task forces for further consideration and action.

The "Regulatory Considerations" document covers a wide range of issues, such as enhancing the disclosure and surveillance of affiliation and control structures, investment management agreements, capital maintenance agreements, complex and non-publicly traded assets, offshore reinsurance and sidecar arrangements and asset adequacy testing. The document also emphasizes that most of these issues are not limited to PE-owned insurers, but are applicable to any insurers that engage in these activities. It reflects the regulators' efforts to update and strengthen their regulatory framework and tools to keep pace with the evolving and dynamic nature of the insurance industry and PE investors in insurance.

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[11] Our team previously published a detailed overview of "Acquiring Ownership: Considerations in Acquiring a "Controlling" Interest in a US Insurance Company," which can be found at: https://www.mayerbrown.com/-/media/files/perspectives-events/publications/2019/07/mayer_brown_insurance_regulatory_corner_acquiring_ownershipjul2019.pdf?rev=04ef1e01163f42e2aea154b5ae53d896.

[12] The "Regulatory Considerations" document has been annotated to include comments from regulators and interested parties and to memorialize the referrals to other NAIC working groups to address the various considerations. The latest version of that annotated document is available at https://content.naic.org/sites/default/files/inline-files/Plan%20for%20the%20List%20of%20MWG%20Considerations%20-%20PE%20Related%20and%20Other.pdf.

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Among those recent changes as noted in the "Regulatory Considerations" document, there has been a reassertion by US state insurance regulators that—although there is a statutory presumption under the US states' insurance laws of control by an investor having direct or indirect ownership of 10% or greater of an insurer's voting securities—control may be found at less than 10% ownership. For example, the New York DFS issued a circular letter regarding "Acquisitions of Control and Disclaimers of Control" in 2022, stating that "an acquiror of less than 10% of an insurer's voting securities, or with the right to appoint a single board member, may still be deemed to control the insurer based on all the facts and circumstances, including the terms and conditions of the proposed transaction."[13] As a result, insurance regulators may decide that an investor with less than 10% ownership of an insurer exercises controlling influence over an insurer through such factors as board and management representation or contractual arrangements and rights (such as non-customary minority shareholder rights or covenants, investment management agreement provisions, such as onerous or costly termination clauses, or control or discretion over the insurer's investment strategy and its implementation).

Most recently, the NAIC's Life Actuarial (A) Task Force ("LATF") has commenced deeper consideration of issues with respect to asset-intensive reinsurance ceded offshore. Among other matters, LATF issued a proposal to require asset adequacy testing for ceded reinsurance transactions.[14] These developments, although not necessarily targeted specifically or solely at PE investors in insurance, are likely to have ramifications for PE investors' strategies for their insurance businesses.

Another area of NAIC activity that has affected PE-owned insurers (though not exclusively PE-owned insurers) has been a series of initiatives during the past several years relating to the treatment of insurance company investments. These initiatives include:

- establishing a new requirement that principal-protected securities with a variable return component must be filed with the NAIC's Securities Valuation Office ("SVO") rather than receiving an NAIC credit quality designation based on their ratings from rating agencies;
- in the case of insurance company investments that have a private letter rating, requiring the private letter rating rationale report to be filed with the SVO;
- adopting a new, principles-based definition of "bond" to take effect in 2025, under which certain types of investments that are in the form of debt securities (including the principal-protected securities described above) will no longer qualify as bonds for statutory accounting purposes;
- increasing the RBC charge for the "residual" (i.e., first loss) tranches of asset-backed securities from 30% to 45%;[15]
- considering adoption of a proposal that would give the SVO the authority to challenge and potentially override rating agency ratings on specific securities owned by insurance companies;
- considering developing a more robust due diligence framework for the NAIC's accreditation of rating agencies to be able to provide ratings that are used for determining RBC charges on securities owned by insurance companies;

[13] https://www.dfs.ny.gov/industry_guidance/circular_letters/cl2022_05.
[14] Please see our fuller discussion of this development in our article entitled "US NAIC Spring 2024 National Meeting Highlights: Life Actuarial (A) Task Force,", which can be found at: https://www.mayerbrown.com/en/insights/publications/2024/03/us-naic-spring-2024-national-meeting-highlights-life-actuarial-a-task-force.
[15] As of this writing, an industry effort is under way to delay the effective date of this RBC charge increase until 2025, in order to allow for further study and analysis. The outcome of that effort is uncertain.

- doing a ground-up review of the system for determining RBC charges on collateralized loan obligations, collateralized fund obligations and other types of asset-backed securities with tail risk; and
- considering more robust criteria for regulators to use when reviewing the provisions of investment management agreements between insurers and affiliated investment managers.

Global Trend for Regulatory Scrutiny of PE Investors in Insurance

Although this article's discussion has focused on increased scrutiny by US state insurance regulators of PE investors in insurance, such scrutiny has also arisen at the US federal level (such as in US Senate hearings in 2022), as well as in other jurisdictions and on a global level. For example, the Bermuda Monetary Authority issued a paper on December 18, 2023, regarding supervision and regulation of PE insurers in Bermuda;[16] similarly, the International Monetary Fund issued a white paper on PE investments into the life insurance industry.[17]

* * *

The regulatory scrutiny of PE investments in insurance continues to develop. As such, it is important for PE investors to not only understand the insurance regulatory landscape at the present time, but also look ahead to understand how the regulators' scrutiny might evolve in the future.

[16] BMA's paper can be found at: https://www.bma.bm/news-and-press-releases/supervision-and-regulation-of-private-equity-insurers.
[17] IMF's paper can be found at: https://www.imf.org/en/Publications/global-financial-stability-notes/Issues/2023/12/13/Private-Equity-and-Life-Insurers-541437.

Delaware Supreme Court Reaffirms Business Judgment Rule Standard

By: Brian Massengill, Andrew Noreuil and Matthew Sostrin

On April 4, 2024, in *In re Match Group, Inc. Derivative Litigation*,[18] the Delaware Supreme Court, sitting *en banc*, reaffirmed the requirements for obtaining the business judgment rule standard of review for transactions involving controlling stockholders. The Supreme Court held that the business judgment rule applies to controlling stockholder transactions *only* if the transaction is negotiated and approved by an independent, special committee *and* is approved by a fully informed vote of a majority of the minority stockholders. The Supreme Court further held that *all* special committee members—not just a majority—must be independent of the controlling stockholder.

Background

In 2019, IAC/InteractiveCorp ("IAC") separated from its controlled subsidiary, Match Group, Inc. ("Match"), through a reverse spinoff. At the time, Match was publicly traded but IAC held 24.9% of Match's common stock and 98.2% of Match's voting power. IAC told Match at the outset that any transaction would be conditioned on both the recommendation of a Match board special committee and the approval of the holders of a majority of the shares held by Match's unaffiliated stockholders. Match's board appointed a "Separation Committee" to assess a proposed transaction. The Separation Committee included Thomas McInerney, IAC's former Chief Financial Officer. The Separation Committee negotiated the separation and recommended that the Match board approve the separation. The Match board did so by a unanimous vote. Match's unaffiliated stockholders also approved the separation.

Former Match minority stockholders challenged the separation in the Court of Chancery, alleging that IAC received disproportionate benefits at their expense. The plaintiffs alleged that the transaction was subject to entire fairness review—not the deferential business judgment rule—because the Separation Committee, and McInerney in particular, was not sufficiently independent from IAC, and the minority stockholder vote was not fully informed.

The Court of Chancery granted defendants' motion to dismiss. The Court held that the separation satisfied the requirements set forth in *Kahn v. M & F Worldwide Corp.* ("*MFW*")[19] for controlling stockholder transactions to be subject to business judgment rule review. The Court found that IAC properly conditioned the separation on the approval of a fully empowered, well-functioning special committee of independent directors and the uncoerced, informed vote of the minority stockholders. Although the Court acknowledged that plaintiffs alleged facts undermining McInerney's independence, the Court found that plaintiffs would need to allege that a majority of the Special Committee lacked independence, which they did not do. The Court further found that the minority stockholder vote was fully informed.

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[18] --- A.3d ---, 2024 WL 1449815 (Del.).

[19] 88 A.3d 635 (Del. 2014).

The Supreme Court's Decision

Controlling stockholder transactions are subject to heightened entire fairness review unless the controller takes steps to ensure that the transaction has the characteristics of an arm's-length negotiation. In *MFW*, the Delaware Supreme Court previously held that the more deferential business judgment rule will apply when: (i) a controlling stockholder conditions a transaction from the start on the approval of both a special committee and a majority of the minority stockholders; (ii) the special committee is independent; (iii) the special committee is fully empowered; (iv) the special committee meets its duty of care; (v) the vote of the minority stockholders is informed; and (vi) there is no coercion of the minority.

In *Match Group*, the Supreme Court reaffirmed that the *MFW* requirements apply to all controlling stockholder transactions where defendants seek to shift the standard of review to the business judgment rule. The defendants in *Match Group* had sought to limit *MFW* to freeze out mergers and argued that the business judgment rule otherwise applied to a controlling stockholder transaction, as long as the transaction was approved by *either* a board with an independent majority *or* an independent special committee *or* a fully informed, unaffiliated stockholder vote. The Supreme Court rejected defendants' arguments, and confirmed that the business judgment rule applies only if a controlling stockholder transaction is approved by *both* an independent special committee *and* a majority of the minority stockholders. The Supreme Court recognized that there is a heightened concern for self-dealing whenever a controlling stockholder stands on both sides of a transaction and receives a non-ratable benefit.

The Supreme Court further held that *MFW*'s requirements are satisfied only when all special committee members—not merely a majority—are independent. The Supreme Court agreed that McInerney lacked independence. He had worked for IAC from 1999 through 2012, including a seven-year term as IAC's CFO. During that time, McInerney earned over $55 million from IAC. McInerney was also close with IAC's Chairman, senior executive and largest stockholder, Barry Diller. The Supreme Court explained that a controlling stockholder's influence is not disabled when the special committee is staffed with members loyal to the controlling stockholder. As a result, the Supreme Court held that entire fairness remained the standard of review and that the Court of Chancery improperly dismissed plaintiffs' claims.

Implications

After the *MFW* decision, some corporations began to use the *MFW* structure to shift the standard of review to the business judgment rule for controlling stockholder transactions other than freeze-out mergers, sometimes referred to as "*MFW* creep," which led some, including former Delaware Supreme Court Chief Justice Leo Strine, to question whether *MFW* was necessary to obtain business judgment review for all controlling stockholder transactions. *Match Group* makes clear that Delaware courts will apply entire fairness—the highest standard of review—to all controlling stockholder transactions where the controller receives a non-ratable benefit unless the controller complies with *MFW*. The Supreme Court rejected attempts to limit *MFW*'s requirements to only freeze out mergers and stated that the same concerns that led to *MFW* being adopted for freeze-out mergers are present any time a controlling stockholder stands on both sides of a transaction.

In the context of controlling stockholder transactions, *Match Group* also reaffirms the need for boards of directors to take care in setting up special committees to ensure that all members are independent of the controlling stockholder. IAC had attempted to comply with *MFW*'s requirements by conditioning the separation from the outset on the approval of a special committee and a majority of unaffiliated stockholders. But those efforts were unsuccessful, as the Supreme Court agreed that it was reasonably conceivable that one special committee member lacked independence—even though he had not worked for IAC for seven years.

New York's Special Facts Doctrine: Not So Special For Sellers?

By: Rory K. Schneider and Noelle Jolin

New York law is often chosen to govern commercial transactions between sophisticated parties, especially parties located in different regions of the world. It is natural for such parties to expect that, as a global epicenter of commercial activity, New York law would be particularly respectful of the terms to which they agree after an arm's-length negotiation. One oft-ignored or underappreciated aspect of New York law that can undermine this predictability is known as the "special facts" or "peculiar knowledge" doctrine.

Under that doctrine, sellers may be found to have a duty to disclose information beyond what is expressly required by contract, and therefore be subject to unanticipated fraud claims for violating that duty. The doctrine is even considered an exception to otherwise effective disclaimers of reliance on all but the express representations and warranties in a transaction agreement. There are available defenses, but they frequently prove too fact-intensive to achieve early dismissal of claims. Buyers and sellers alike should consider the existence of the doctrine when selecting New York law to govern their agreements and its potential implications.

The special facts doctrine can give rise to an extracontractual duty to disclose

Arm's-length commercial transactions do not normally create a fiduciary relationship between the parties, or otherwise impose a duty to speak. The parties' disclosure obligations are usually, and fittingly, defined by the agreed-upon terms of the contract. However, New York law recognizes an important exception known as "*the special facts doctrine*" that surprises many, including, in particular, those parties who select New York as the governing law for a contract when unaware of the doctrine's existence.

According to the doctrine, a party with superior knowledge of a material fact has a duty to disclose when non-disclosure would render the transaction "inherently unfair." While questions of fairness are highly fact-dependent, courts generally focus on the existence of substantial informational asymmetry between parties. Specifically, the doctrine applies when: (1) information is within the non-disclosing party's peculiar knowledge; and (2) the other party could not have discovered it through the exercise of reasonable diligence. When those conditions are satisfied, a failure to disclose by a party with superior access to material information can support a post-closing fraud claim.

Of course, in an M&A deal, the seller always knows, and has access to, considerably more information about the company being sold than the buyer. One important purpose of the diligence process, and the eventual negotiation of written representations and warranties, is to identify the information that the parties agree is material and correct that imbalance with respect to the issues they address.

But because there is plenty of information uniquely in the seller's possession that may not need to be disclosed as a strict contractual matter and might escape even reasonable diligence, the special facts doctrine creates unforeseen risk for sellers (and greater flexibility for buyers to pursue claims post-closing).

The special facts doctrine may even supersede contractual disclaimers of reliance

Sellers typically seek protection from post-closing fraud claims through common contractual disclaimers. Among other things, it is commonplace in M&A transactions for sellers to disclaim any representations and warranties beyond those expressly set forth in the agreement, and for buyers to disclaim reliance on all but those express representations and warranties. As reasonable reliance is a necessary element of any fraud claim, these disclaimers can foreclose post-closing fraud claims based on information outside of the contract.

Though New York courts do not categorically enforce all reliance disclaimers to dismiss fraud claims, they are more apt to do so where the disclaimer is either: (1) specific to the subject of the alleged misrepresentation; or (2) part of comprehensive agreement between sophisticated parties that includes detailed written representations and warranties (in which case, a general disavowal of other representations and warranties may also be effective).

But part of what makes the special facts doctrine so significant is that New York courts frequently refer to the doctrine as an *exception* to the enforceability of such disclaimers. That is, invocation of the special facts doctrine may allow a buyer to avoid a contractual disclaimer that would otherwise preclude a fraud claim based on information outside the scope of an agreement. An unsuspecting seller whose agreement is governed by New York law may, therefore, be exposed to claims it believed to be foreclosed by the agreement's express terms.

At a minimum, the doctrine can prevent early dismissal of such claims. The elements on which the doctrine's application turns—whether information is uniquely accessible to the seller and whether a reasonable buyer would have uncovered the information during the diligence process—cannot, in many cases, easily be resolved as a matter of law at the start of litigation. Invocation of the doctrine will often necessitate costly and time-consuming discovery.

* * *

Transacting parties should account for the special facts doctrine when considering whether to select New York law as their governing law. Delaware does not have an equivalent doctrine, and may therefore provide more certainty with respect to the prospect of post-closing fraud claims based on conduct not encompassed by the written contract.

If New York law is selected, sellers should consider what potentially significant information about the asset may fall outside the scope of the diligence information exchanged and the resulting written representations and warranties. The existence of the special facts doctrine could counsel in favor of additional disclosures and/or the inclusion of additional contract provisions. Such provisions might include, for example, an express prohibition on claims based on the failure to disclose information unrelated to the express representations and warranties in the contract.

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