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PUTTING VERTICAL MERGER CONCERNS TO BED: LESSONS FROM THE FTC'S FAILED ATTEMPT TO BLOCK TEMPUR SEALY'S MERGER WITH MATTRESS FIRM

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On January 31, a federal court in Texas rejected the Federal Trade Commission's ("FTC") attempt to block the $4 billion acquisition by Tempur Sealy, the world's largest mattress manufacturer, of Mattress Firm, the largest mattress retailer in the United States.[1] This is the latest in an almost unbroken series of defeats that the U.S. antitrust enforcement agencies have encountered in the Biden administration's campaign to ramp up challenges to so-called "vertical" mergers—mergers between firms at different levels in the distribution chain. While it remains to be seen whether the agencies will continue to pursue this policy under the Trump administration, the decision highlights the judiciary's long-cautious stance on vertical merger enforcement generally and the challenges that policy likely would encounter. The decision also marks yet another win for "litigate the fix" strategies, where parties unilaterally offer, and defend in court, divestitures or other remedies to resolve competitive concerns about the underlying transaction.

This article summarizes the FTC's challenge to the Tempur Sealy/Mattress Firm merger and the reasons why the court rejected that challenge, and provides key takeaways for firms contemplating similar transactions.

The FTC's Challenge to Tempur Sealy/ Mattress Firm

The transaction began in May 2023, when Tempur Sealy announced a definitive agreement to purchase Mattress Firm. Mattress Firm, the nation's largest mattress specialty retailer, with over 2,400 brick-and-mortar retail stores, carries mattresses from multiple suppliers and brands across a wide range of price points and product features, which it displays to customers in "slots" at each store. Tempur Sealy is one

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of Mattress Firm's largest brands, but Tempur Sealy also sells its mattresses through other channels, including other multi-brand retailers and its own exclusive retail stores.

As part of the transaction, Tempur Sealy simultaneously entered into commitments to (a) divest a number of retail stores to a smaller retailer, Mattress Warehouse, and (b) guarantee a percentage of Mattress Firm's slot space to rival mattress manufacturers for at least five years.

In July 2024, a unanimous FTC voted to issue an administrative complaint challenging the merger and seek a preliminary injunction from the Texas federal court barring the closing of the merger until the FTC could complete its in-house administrative adjudication.[2] The FTC's complaint alleged that this merger would substantially lessen competition in the United States market for "premium mattresses,"[3] which the FTC defined to mean mattresses sold at or above a price point of $2,000.[4]

The FTC's Complaint asserted that the merger may substantially lessen competition in the premium mattress market under two separate standards. First, the FTC argued that Tempur Sealy would have the ability and incentive to cut off (or foreclose) rival mattress suppliers' access to Mattress Firm by reducing the number of mattresses carried at each store, expelling brands that threatened Tempur Sealy's own brand, or steering customers away from rival brands (the so-called "ability-and-incentive" standard).[5] Second, the FTC argued that the traditional factors articulated by the Supreme Court in *Brown Shoe Co. v. United States*[6] also showed the probability that the merger would harm competition (the "*Brown Shoe* factors").[7] Specifically, the FTC alleged that the combined firm would possess "substantial" market power and display a "significant" likelihood and degree of potential foreclosure in a market allegedly possessing high barriers to entry.[8]

The Court's Decision

Following a seven-day evidentiary hearing in November 2024, the court denied the FTC's request for a preliminary injunction. The court rejected nearly the entirety of the FTC's case-in-chief, including its alleged "premium mattress" market definition as well as both FTC theories on competitive harm. In addition, the court concluded that even if the FTC had met its burden of proof, Tempur Sealy's remedies (including certain retail divestitures and slot commitments) were sufficient to resolve any lingering concerns.

Market definition. At the outset, the court determined that the FTC failed to meet its burden to define a relevant antitrust market in which to assess competitive effects. In the court's view, the evidence did not support a bright-line distinction of a "premium" mattress

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market priced above $2,000.[9] Rather, the court noted, there was no industry or public consensus regarding the FTC's proffered $2,000 price point, nor were there any product characteristics unique to mattresses priced above that point. Instead, the evidence suggested that mattresses are sold across a pricing spectrum, not within distinct price bands.

It is not uncommon for the agencies to pursue—and a number of courts have accepted—narrow market definitions, including for "premium" products in a larger market. As one example, the FTC recently pursued—and the court accepted—a market definition of "accessible luxury" handbags in *FTC v. Tapestry*, a recent agency win challenging a horizontal merger.[10] But the *Tempur Sealy* court distinguished that and similar cases, explaining that the parties' ordinary-course documents in *Tapestry* "frequently and consistently" identified the existence of an "accessible luxury" market, as did others in the industry.[11] This kind of evidence was absent in mattresses.

Potential competitive harm from the merger. In addition, the court concluded the FTC failed to show that the merger was likely to substantially lessen competition in the alleged premium mattress market, under either the "ability-and-incentive" standard or under the traditional *Brown Shoe* factors.

At the outset, the court acknowledged that academic literature, antitrust enforcers, and case law alike have "repeatedly recognized" that vertical mergers like Tempur Sealy/Mattress Firm "may serve to benefit competition and consumers." To prevail, the FTC must show that a combined Tempur Sealy/Mattress Firm would "gain such substantial power as to render the relevant market non-competitive"—a high bar for the agency.

Under both standards, the court concluded that the FTC had shown that the transaction would allow Tempur Sealy to foreclose rivals from selling at Mattress Firm. The court cited Tempur Sealy board presentations discussing the control that Tempur Sealy would obtain over retail channels, and other ordinary-course evidence also confirmed that the post-merger firm would "have a profit-aligned incentive to increase the sales of Tempur Sealy mattresses."[12] Whether or not Tempur Sealy possessed an actual plan to implement this foreclosure, the court held that the objective possibility that it could engage in this behavior sufficed for the ability-and-incentive test and similarly supported two of the *Brown Shoe* factors.[13]

But that was not the end of the analysis. In addition to showing the potential for foreclosure, the court required the FTC also to "show substantial harm to [retail] competition" under both the ability-and-incentive standard and the *Brown Shoe* factors.[14] And while the FTC asserted that the merger would likely enable the merged firm to increase prices, reduce innovation, and erect higher barriers to entry, the court found that the FTC failed to carry its burden on each theory of harm.

First, the court found the FTC's theory that the merger would lead to higher prices rested not on evidence but only faulty and unfounded assumptions. Among other things, the FTC's expert ignored one of the principal efficiencies of vertical mergers: the elimination of double marginalization, and its likely result of *lower* (not higher) prices to consumers. The FTC's expert also ignored substantial evidence demonstrating that (a) mattress retailers compete vigorously on prices, and (b) the same mattress can be priced at wildly varying prices across retailers, preventing Mattress Firm from unilaterally raising prices. As one example, a Purple-branded mattress was sold at $2,594 at a Mattress Firm store and at just $675 at a rival retailer during the same month.[15] The court held that the FTC's assertion that rivals would quit competing on price post-transaction "simply doesn't accord with reality."[16]

Second, the court rejected the FTC's theory that the merger would injure competition (and not just competitors) if Tempur Sealy stopped rival mattress manufacturers from selling to retail customers through Mattress

Firm. Critically, the court cited the FTC's own analysis showing that Mattress Firm accounted for just 25% of retail mattress sales priced over $2,000—two-thirds of which were already Tempur Sealy branded.[17] With so many alternative routes to retail these mattresses, the foreclosure of at most 8.8% of the premium market presented no concern for competition, the court found.[18] In support of its conclusions, the court also observed that rival mattress manufacturers do not rely on Mattress Firm "principally, or at all" for their success, citing competitors like Avocado and Sleep Number that sell through wholly separate retail outlets—before even considering online-only sales.[19]

Finally, the court rejected FTC's miscellaneous, other theories of harm as "even more attenuated."[20] For example, the FTC argued that the merger would enable Tempur Sealy to acquire confidential information and proprietary technology that Mattress Firm collected from its other suppliers. But even if this possibility were true, the court reasoned, there was no reason that other mattress sellers had to continue selling at Mattress Firm, and, at any rate, Tempur Sealy committed to establish firewalls to protect this information.[21] The court also commented that testimony from rival manufacturers' testimony raising these concerns "appear[ed] exaggerated and self-serving."[22]

Tempur Sealy's remedy commitments. Finally, the court found that even if the FTC had shown the merger may substantially harm competition, Tempur Sealy's proposed remedial commitments sufficed to permit the merger to proceed. The retail store divestitures to which Tempur Sealy committed would "guarantee[] further, reasonable retail alternatives for . . . rivals of Tempur Sealy by reducing both Mattress Firm's market share and the already-low total possible foreclosure percentage."[23]

Notably, the parties ***expanded*** their commitment to reserve third-party slots at Mattress Firm after the conclusion of the preliminary injunction hearing in response to the court's skepticism about the scope of parties' proposed remedies (and even asking during closing arguments why Tempur Sealy did not "simply commit to maintaining a floor balance closer to the current status quo).[24] The court dismissed FTC objections to the consideration of the parties' eleventh-hour proposal because it "simply addresses and updates points that have been plainly at issue for the duration of the litigation," and instead praised the parties' "remarkable good faith" on resolving competitive concerns.[25]

Tempur Sealy Confirms Judicial Skepticism of Aggressive Vertical Merger Enforcement

Tempur Sealy caps a recent string of court decisions rejecting the enforcement agencies' efforts to bolster challenges to vertical mergers. For example, in *United States v. AT&T*,[26] a court rejected the Department of Justice's ("DOJ") theory that AT&T's acquisition of Time Warner would substantially lessen competition in video programming and distribution by enabling AT&T to charge rival video distributors higher prices for Time Warner's "must have" content and to force internet video distributors to deal with AT&T's DirecTV subsidiary.[27] The court rejected these claims, in part because the DOJ failed to show AT&T would have "*any* incentive to foreclose rivals' access" to this content.[28] And, like the range of mattress retail options available to rival mattress manufacturers in *Tempur Sealy*, the court doubted that AT&T's content was actually "must-have" given the range of entertainment options available to rival distributors.[29]

The government vertical-foreclosure theories found no more traction in *United States v. UnitedHealth Group*.[30] In that case, UnitedHealth Group ("UHG") proposed to buy Change Healthcare, a company that provided data processing services for medical claims and maintained the nation's largest electronic clearinghouse for medical claims. The DOJ alleged that UHG's control of Change's clearinghouse would allow UHG to access rivals' confidential, competitively-sensitive information, but the court found otherwise, ruling that UHG would instead follow its incentives to protect external customer data and that customers could still contract for protections on top of existing firewalls.[31]

As for the DOJ's claim that UHG could foreclose access to the clearinghouse and its integrated platforms, the court saw no reason why UHG would face any post-merger incentives to abandon its current multi-payer strategy.[32]

So too, in *FTC v. Microsoft*,[33] the court rejected the FTC's claims that Microsoft's acquisition of Activision would substantially lessen competition for video games by incentivizing Microsoft to deny rival gaming platforms access to Activision's *Call of Duty* video games and reserve them to Microsoft's Xbox platform. The FTC argued that it need only show that Microsoft would obtain the ability and incentive to foreclose rivals from accessing *Call of Duty*.[34] But just as in *Tempur Sealy*, the *Microsoft* court doubted that the ability-and-incentive test could establish a substantial harm to competition, and instead concluded that Microsoft lacked the incentive to foreclose access to *Call of Duty*.[35] That conclusion was reinforced by Microsoft's commitment to maintain Sony PlayStation's access to the video game franchise.[36]

Each of these cases—and now *Tempur Sealy*—demonstrates the courts' healthy, long-standing skepticism about the anticompetitive effects posed by vertical mergers. In particular, each court closely scrutinized the agencies' asserted harms against the parties' real-world business conduct, weighed against the parties' remedies to resolve the agencies' concerns. And in each case, the courts rejected the agencies' theoretical concerns as not enough to support an order blocking the deals.

Key Takeaways

Following are the lessons we expect the FTC's failure to obtain a preliminary injunction against Tempur Sealy signals for vertical merger enforcement in the future.

1. The conventional wisdom "that vertical mergers may serve to benefit competition and consumers" remains alive and well.[37] Outside of extreme situations, courts are likely to remain skeptical about potential anticompetitive harm from vertical mergers.
2. Courts continue to require antitrust agencies to show harm to *competition* from vertical mergers, not just the ability and incentive to foreclose rivals. This is a much higher burden than the agencies may suggest in merger review.
3. Market definition remains a critical aspect of vertical merger analysis. The *Tempur Sealy* court rejected the FTC's narrow market definition of premium mattresses priced above $2,000, highlighting that market definition must reflect economic reality and be consistent with how industry players think about the market in the ordinary course.
4. As in any litigation, credibility of witnesses is critical. The *Tempur Sealy* court was particularly dismissive of testimony from competing mattress manufacturers, which the court generally found "self-serving," "exaggerated," and effectively impeached by the parties. By contrast, the court found credible the testimony from party executives about the post-merger entity's future plans and commitments.
5. *Tempur Sealy* marks the fourth judicial decision in recent years rejecting the agencies' aggressive vertical merger enforcement. The cumulative effect of those losses will likely dissipate the deterrent effect of potential agency action on vertical mergers and should serve as a cautionary tale for the agencies in the new administration.
6. Remedies remain an effective avenue to resolve agency concerns to vertical mergers, including behavioral commitments to protect third-party access and information sharing. As *Tempur Sealy* shows, the window to "litigate the fix" does not close once regulators have filed a challenge, or even after the hearing concludes.

7. The FTC relied heavily on the parties' documents to support its foreclosure theory that Tempur Sealy could profitably remove rivals from Mattress Firm. Company documents have long been a source for antitrust enforcer soundbites about how mergers can harm competition. Antitrust enforcer theories in vertical mergers (or other non-horizontal theories) may be less familiar to business leaders. Companies should consider educating employees about how to avoid statements that could later be used against them, either because they have no basis in fact or because they are misconstrued by enforcers.

The views and opinions set forth herein are the personal views or opinions of the authors; they do not necessarily reflect views or opinions of the law firm with which they are associated.

ENDNOTES:

[1]*Federal Trade Commission v. Tempur Sealy International, Inc*, 2025 WL 384493 (S.D. Tex. 2025).

[2]Fed. Trade Comm'n, FTC Moves to Block Tempur Sealy's Acquisition of Mattress Firm (July 2, 2024), https://www.ftc.gov/news-events/news/press-releases/2024/07/ftc-moves-block-tempur-sealys-acquisition-mattress-firm.

[3]Complaint at 27-30, *Federal Trade Commission v. Tempur Sealy International, Inc*, 2025 WL 384493 (S.D. Tex. 2025), ECF 1.

[4]*Tempur Sealy*, 2025 WL 384493, at *14.

[5]Complaint at 31-33.

[6]*Brown Shoe Co. v. U.S.*, 370 U.S. 294, 82 S. Ct. 1502, 8 L. Ed. 2d 510 (1962).

[7]Complaint at 42.

[8]*Id.* at 42-44.

[9]*Tempur Sealy*, 2025 WL 384493, at *15.

[10]*Id.* at *17 (quoting *Federal Trade Commission v. Tapestry, Inc.*, 2024 WL 4647809, at *20 (S.D. N.Y. 2024)).

[11]*Id.* (quoting *Tapestry*, 2024 WL 4647809, at *20).

[12]*Id.* at *31.

[13]*See id.* at *28.

[14]*Id.* at *29, *24.

[15]*Id.* at *40. This led to related concerns about whether this Purple mattress was in the FTC's relevant market, given that it met the $2,000 price point threshold at some retailers but not others.

[16]*Id.* at 40.

[17]*Id.* at *42-43.

[18]*Id.* at *43.

[19]*Id.* at 42.

[20]*Id.* at *46.

[21]*Id.* at *47.

[22]*Id.*

[23]*Id.* at *51.

[24]*Id.* at *51-52. The court found that the parties' revised commitments preserved almost 43% of the relevant floor slots for third-party competitors' mattresses. *Id.* at *9, *51.

[25]*Id.* at *51-52. The court found that the parties' revised commitments preserved almost 43% of the relevant floor slots for third-party competitors' mattresses. *Id.* at *9, *51.

[26]*United States v. AT & T Inc.*, 310 F. Supp. 3d 161, 2018-1 Trade Cas. (CCH) ¶ 80407 (D.D.C. 2018), aff'd, 916 F.3d 1029, 2019-1 Trade Cas. (CCH) ¶ 80685 (D.C. Cir. 2019).

[27]*See id.* at 194, 202.

[28]*Id.* at 251.

[29]*Id.* at 203.

[30]*United States v. UnitedHealth Group Incorporated*, 630 F. Supp. 3d 118 (D.D.C. 2022), dismissed, 2023 WL 2717667 (D.C. Cir. 2023).

[31]*Id.* at 144, 146-48.

[32]*Id.* at 154.

[33]*Federal Trade Commission v. Microsoft Corporation*, 681 F. Supp. 3d 1069 (N.D. Cal. 2023).

[34]*Id.* at 1089.

[35]*Id.* at 1090.

[36]*See id.* at 1090-93.

[37]*Tempur Sealy*, 2025 WL 384493, at *12.

TRANSFORMATIVE AMENDMENTS PROPOSED TO DELAWARE GENERAL CORPORATION LAW

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For well over half a century, Delaware has taken a balanced and predictable approach to corporation governance and resolving business disputes. While the law has changed at times, those changes have been evolutionary and, with rare exceptions, met the common sense test. The high level of clarity and certainty Delaware statutory law and judicial decisions historically provided led two-thirds of Fortune 500 companies to choose Delaware as their legal home and to stay there.

But over the past year, boards of directors of public companies and key stockholders of companies about to go public[1] have been reconsidering whether to domicile in Delaware. These discussions have been prompted by a number of recent decisions of the Delaware courts. Some called into question the validity of decades-old practices with respect to stockholder and merger agreements, which was met with a swift legislative response in 2024.[2] Others broke new ground on a range of other issues, including standards of review for controlling stockholder and other interested transactions and the ability of plaintiffs' lawyers to obtain an ever-expanding set of corporate documents to fish for reasons to sue public companies. The scope, speed and substance of these decisions surprised key stakeholders and threaten to undermine the predictability and precedential reliability that traditionally has been the hallmark of Delaware courts.

In view of these developments, a bipartisan coalition of Delaware lawmakers has proposed legislation[3] to amend the Delaware General Corporation Law ("DGCL") to restore greater clarity and predictability in structuring controller and other interested transactions and to protect against frivolous litigation by narrowing stockholder access to corporate books and records. While it is still in the early stages and changes to the bill may be proposed as the legislative process moves forward, we believe the amendments in their current form make a great deal of sense and would significantly bolster confidence in Delaware among key stakeholders.

Separately, the same lawmakers sponsored a Senate concurrent resolution[4] that asks the Council of the Corporation Law Section of the Delaware State Bar Association to provide a report by March 31, 2025 with recommendations for additional legislation to address excessive fee awards to plaintiffs' attorneys while still incentivizing stockholder litigation that is protective of stockholder rights. We believe change is urgently needed in this area as well, particularly given several recent nine-figure fee awards, including one for $345 million.

Proposed Amendments Regarding Controlling Stockholder and Interested Transactions

Background on Current Legal Framework

The default standard of review in Delaware for reviewing fiduciary conduct is the business judgment rule, which presumes that directors make decisions in good faith, on an informed and independent basis, and free of material conflicts of interest. However, when a controlling stockholder stands on both sides of a transaction and receives a non-ratable benefit, the far more onerous standard of entire fairness applies.

Entire fairness review places the burden on defendants to prove that the challenged transaction was entirely fair, taking into account both process and financial considerations. Entire fairness also applies to a transaction if a plaintiff demonstrates that a majority of the directors were interested in the transaction or were not independent from someone interested in the transaction.

The only way to obtain business judgment review in conflicted controller transactions is for the parties to follow the "*MFW* framework." That standard requires that the controller condition the transaction on the approval of *both* (1) a wholly independent,[5] fully-empowered special committee that meets its duty of care and (2) a fully informed, uncoerced vote of a majority of the minority stockholders ("MoM vote").

Issues with Current Framework

Although the above principles may seem straightforward and sensible, the *MFW* framework and other jurisprudence concerning controller and interested transactions have become increasingly difficult for parties to successfully comply with in order to obtain pleadings-stage dismissals, thus driving up litigation expense even where the transactions are ultimately determined to be entirely fair. This trend is the result of a string of recent court decisions that have taken a far more expansive view of what constitutes a controlling stockholder and what rises to the level of a non-ratable benefit than traditionally had been the case.[6] As a result, the decision-making of independent directors who have no financial interest in the transactions they approve has been subjected to entire fairness review where their actions are susceptible to being second-guessed and plaintiffs' lawyers gain undue leverage to extract expensive and unnecessary litigation settlements.

The proposed amendments to DGCL Section 144 would reset the standards governing controller and interested transactions to provide more predictability, give greater deference to independent directors and rebalance litigation incentives in a beneficial way. In particular, the proposed amendments would make the following key changes.

- **Non-squeeze out mergers with controllers and other interested transactions would have to satisfy only one prong of a modified *MFW* framework to receive protection from liability.** The MoM vote required by the *MFW* framework not only may add significant deal risk to a transaction depending on the stockholder profile of the target, it also adds significant litigation risk because legal challenges concerning the adequacy of disclosures to stockholders and whether a stockholder vote was coerced increasingly have been effective to defeat dismissals of lawsuits where a transaction was conditioned on the *MFW* framework.[7] The proposed amendments would mitigate these risks (and the attendant expense of costly, post-pleading litigation) for both controller transactions that do not involve squeezing out minority stockholders and for any other "interested transaction" because defendants would only need to satisfy *one* prong of a modified *MFW* framework to benefit from a new safe harbor that would protect directors, officers and controllers from liability and equitable relief. Thus, in these transactions, a proper special committee process will invoke the safe harbor, so that decision-making by independent directors cannot be second-guessed and litigation can more easily be dismissed at the pleadings stage. Only in controller mergers where the minority stockholders are being squeezed out would both prongs of the modified *MFW* framework be required.

- **Sets a floor on controller status**. Under Delaware law, controlling stockholder status attaches when a stockholder either (1) controls a majority of the corporation's voting power or (2) controls less than a majority of the corporation's voting power, but has effective control over the business and affairs of the corporation. Decisions determining controller status in the latter circumstance have been liberally applied recently, to the point that a strong CEO or Chair who controls less than 22% of a company's voting power could nevertheless be viewed as a controlling stockholder.[8] The proposed amendments would attach controller status to non-majority stockholders only if the stockholder controls at least one-third of the corporation's outstanding voting power *and* has the power to exercise managerial authority of the business and affairs of the corporation. The proposed amendments also clarify that an agreement, arrangement or understanding must exist for stockholders to constitute a control group.

- **Defines director disinterestedness**. The case law concerning director independence and disinterestedness has become increasingly unpredictable,[9] which has made it more difficult to successfully implement a proper special committee process. The proposed amendments would provide greater clarity in this area for purposes of DGCL Section 144 by statutorily defining a "disinterested director" in a common sense way as a director who lacks a "material interest" in the transaction or a "material relationship" with a person that has a material interest in the transaction. While these definitions would leave room for judicial interpretation, they limit the court's ability to engage in intensive and contextual fact finding on these issues under its existing precedents and should make director independence determinations more predictable.

- **Provides favorable presumption with respect to director disinterestedness**. The proposed amendments would add further predictability to director disinterestedness determinations. Over the past few years some decisions have expressed skepticism over director independence as a result of what many have viewed as non-material, non-economic connections to a controller. The amendments address this concern by adding a presumption that directors of public corporations are independent with respect to a transaction if they are not party to the transaction and the board determines that such director is independent or satisfies the criteria for director independence under applicable stock exchange rules.[10] In addition, the amendments provide that a director's nomination or election to the board by a person with a material interest in a transaction would not, by itself, be evidence that the director is not disinterested as to that transaction.

- **Only a majority of directors on a special committee must be disinterested**. The Delaware Supreme Court recently imposed a requirement that every director on a special committee formed for *MFW* purposes must be independent, as opposed to a majority of such directors being independent. While this appears reasonable, it creates the risk that an entire process would be invalidated if a court were to decide after the fact that just one committee member (despite being a minority voice) was not disinterested. The proposed amendments would eliminate that risk by requiring that only a majority, rather than every member, of a special committee must be disinterested.

- **Special committee review or a MoM vote can be implemented at any time during the deal process**. The *MFW* framework requires that both the special committee and MoM vote conditions be put in place *ab initio, i.e.,* before the start of substantive economic negotiations. The failure to condition a transaction *ab initio* on the satisfaction of both protections has resulted in the denial of pleadings stage dismissals in about one-third of the cases where Delaware courts determined that compliance with the *MFW* framework was not met.[11] The proposed amendments would eliminate this *ab initio* requirement.

- **"Votes cast" standard for MoM votes**. The proposed amendments impose a "votes cast" standard for a MoM vote, rather than a majority of the outstanding stock held by minority investors, for controller transactions and other interested transactions. This lower threshold provides greater certainty that a MoM vote can be achieved, particularly for corporations that have a significant number of investors who fail to sign and return proxies.

- **Alternative safe harbor for fairness**. As an alternative to complying with one or both of the modified *MFW* protections, the proposed amendments create a safe harbor to obtain protection from liability and equitable relief for a controlling stockholder or other interested transaction if such transaction is "fair as to the corporation." The amendments define this term to mean that the transaction, as a whole, is beneficial to the corporation or its stockholders taking into account whether the transaction is fair in terms of the relevant fiduciary's dealings with the corporation and approximates an arm's length transaction.[12] This alternative basis for the safe harbor would be particularly helpful in situations where the parties are confident that the deal price is market, but want to avoid the risks that the *MFW* protections may impose.[13]

Proposed Amendments Regarding Books and Records Demands

In recent years, stockholder demands for corporate books and records under Section 220 of the DGCL have been overwhelming the docket of the Court of Chancery. One study indicates that the number of Section 220 cases increased by thirteenfold from the 1981 to 1994 period to the 2004 to 2018 period,[14] and the pace has only increased since then. Further, Section 220 demands have broadened in their scope, requesting an ever-expanding range of documents*, e.g.*, requests for emails and text messages of directors and employees, including from personal devices.[15] The proposed amendments to the DGCL would help curb abuse of Section 220 by plaintiffs' lawyers on "fishing expeditions" and provide much needed relief to corporations overburdened by these demands and the litigation expense associated with them.

- **Narrows accessible books and records**. Disputes between corporations and stockholders often arise over whether stockholders are entitled to documents beyond formal corporate and board records. The Delaware Supreme Court commented in 2019 that corporations should not have to produce electronic documents in response to Section 220 demands if they maintain traditional, non-electronic records (*e.g.*, board minutes and presentations) sufficient to satisfy a proper purpose for inspection,[16] but Section 220 demands have continued to pursue electronic information aggressively even when traditional records are available. The amendments would appropriately reduce the burden of responding to overly aggressive Section 220 demands by limiting "books and records" to a specified list of traditional corporate and board documents that would exclude internal emails, texts or other electronic communications and for some documents limit production to a three-year lookback.[17]

- **Tightens procedural requirements**. Delaware law currently provides that stockholders can demand books and records for a "proper purpose." The proposed amendments would further require that the demand must be made in good faith, and must describe with "reasonable particularity" the stockholder's purpose and the records the stockholder seeks to inspect. If properly applied, these requirements should reduce the burden on public companies and curb frivolous books and records demands.

- **Imposes confidentiality restrictions and permits redactions**. Under the proposed amendments, corporations may impose reasonable restrictions on the confidentiality, use or distribution of any books and records that are produced and may redact portions of documents unrelated to the stockholder's purpose. Although Delaware courts currently have the ability to employ these measures, the proposed amendments would provide corporations with the ability to do so themselves.

Senate Concurrent Resolution Requesting Recommendations on Fee Awards

Delaware courts have recently approved some astronomical plaintiffs' fee awards, with some amounting to nine figures.[18] For example, this past December in *Tornetta v. Musk*, the case that rescinded Elon Musk's $55.8 billion Tesla compensation package, the Court of Chancery approved a plaintiffs' attorneys fee award of $345 million,[19] equating to $17,692 per hour of time worked by the plaintiffs' lawyers.[20] Such excessive fee awards are an unreasonable toll on Delaware corporations and their stockholders.

In response, the same coalition of Delaware lawmakers proposing the amendments discussed above sponsored a Senate concurrent resolution requesting that the Council of the Corporation Law Section of the Delaware State Bar Association, which annually reviews and recommends amendments to Delaware's corporate statutes, provide a report by March 31, 2025 with recommendations for legislative action to ensure that court awards of attorney's fees incentivize stockholder litigation that is appropriately protective of stockholder rights without being excessive to the detriment of Delaware corporations and their stockholders.

Takeaways

We believe that the proposed amendments would be highly beneficial to corporations and their stockholders. The proposed revisions to Section 144 would provide greater clarity and predictability in structuring controller and other interested transactions and would appropriately restore greater deference to the decision-making of independent directors. The proposed revisions to Section 220 would curtail frivolous books and records demands, streamline the process of responding to them, and reduce the burdens they impose on corporations. As noted, the proposed legislation is in its early stages. We will continue to monitor developments.

ENDNOTES:

[1]Typically, many companies planning to go public are in the tech industry and often have a visionary founder as a controller, and many others are former leveraged buyouts that will for some period of time have one or more private equity firms as a controlling stockholder or control group.

[2]In 2024, the Court of Chancery's decisions in *West Palm Beach Firefighters' Pension Fund v. Moelis & Company*, 311 A.3d 809 (Del. Ch. 2024), and *Sjunde AP-fonden v. Activision Blizzard, Inc.*, 2024 WL 863290 (Del. Ch. 2024), as corrected, (Mar. 19, 2024), surprised many practitioners, and the legislature responded with swift statutory reforms (discussed here: https://www.paulweiss.com/media/3984934/delaware_general_assembly_approves_2024_amendments_to_general_corporation_law.pdf).

[3] https://legis.delaware.gov/BillDetail?LegislationId=141857.

[4] https://legis.delaware.gov/BillDetail?LegislationId=141858.

[5]*See In re Match Group, Inc. Derivative Litigation*, 315 A.3d 446 (Del. 2024) (discussed here: https://www.paulweiss.com/practices/transactional/mergers-acquisitions/publications/delaware-supreme-court-affirms-two-condition-mfw-roadmap-to-obtain-business-judgment-review-of-controller-transactions?id=50984).

[6]*See infra* note 8. *See also Palkon v. Maffei*, 311 A.3d 255 (Del. Ch. 2024) (while ultimately reversed by the Delaware Supreme Court, the Court of Chancery initially held that the directors received a non-ratable benefit through the reduction of future liability exposure that justified the application of entire fairness to the corporation's redomestication from Delaware to Nevada), *rev'd*, 2025 WL 384054 (Del. Feb. 4, 2025).

[7]*See* discussion in Paul, Weiss, Rifkind, Wharton & Garrison LLP, *Considering MFW for Controller Transactions?*, Private Equity Digest (Nov. 2024) (https://www.paulweiss.com/media/3985506/private_equity_digest_november_2024.pdf). Also, compare *City of Dearborn Police and Fire Revised Retirement System v. Brookfield Asset Management Inc.*, 314 A.3d 1108 (Del. 2024) (invalidating a MoM vote in an *MFW* analysis in part because the proxy failed to adequately disclose the financial advisor's $470 million stake in the acquirer held in its own account because that level of investment was material to a stockholder in deciding how to vote, although it amounted to only 0.10% of the advisor's total investment portfolio and was likely not material to it) with *In re Micromet, Inc. Shareholders Litigation*, 2012 WL 681785 (Del. Ch. 2012) (holding that the financial advisor's 0.16% investment in the acquirer, which was largely held on behalf of its clients, was not material, and therefore not required to be disclosed).

[8]Compare *Tornetta v. Musk*, 310 A.3d 430 (Del. Ch.

2024) (controller status at 21.9%); *FrontFour Capital Group LLC v. Taube*, 2019 WL 1313408 (Del. Ch. 2019) (controller status at 15%); *In re Zhongpin Inc.Stockholders Litigation*, 2014 WL 6735457 (Del. Ch. 2014) (controller status at 17%) with *In re Oracle Corporation Derivative Litigation*, 2023 WL 3408772 (Del. Ch. 2023), *aff'd*, 2025 WL 249066 (Del. 2025) (no controller status at 28.8%); *Sciannella v. AstraZeneca UK Limited*, 2024 WL 3327765 (Del. Ch. 2024) (no controller status at 26.7%); *In re GGP, Inc. S'holder Litig.*, 2021 WL 2102326 (Del. Ch. May 25, 2021), *aff'd on other grounds*, 282 A.3d 37 (Del. July 19, 2022) (no control at 35.3% with unexercised right to increase stake up to 45%).

[9]Traditionally, Delaware jurisprudence focused on financial factors to assess a director's independence, and there was a high bar to pleading interestedness through non-economic interests. *See, e.g., Beam ex rel. Martha Stewart Living Omnimedia, Inc. v. Stewart*, 845 A.2d 1040 (Del. 2004) (requiring a derivative complaint to plead with particularity facts creating "a reasonable doubt that a director is . . . so 'beholden' to an interested director . . . that his or her 'discretion would be sterilized.' ") (citing *Rales v. Blasband*, 634 A.2d 927, Fed. Sec. L. Rep. (CCH) P 98821 (Del. 1993)). More recently, however, Delaware courts have been increasingly willing to find that non-economic relationships meet this test. *See, e.g., Marchand v. Barnhill*, 212 A.3d 805 (Del. 2019) (stating that courts "cannot 'ignore the social nature of humans' or that they are motivated by things other than money, such as 'love, friendship, and collegiality.' ") (citing *In re Oracle Corp. Derivative Litigation*, 824 A.2d 917 (Del. Ch. 2003)). *See also Sandys v. Pincus*, 152 A.3d 124 (Del. 2016) (holding that the ownership of a plane alone justified a finding of lack of independence because it "requires close cooperation in use, which is suggestive of detailed planning indicative of a continuing, close personal friendship.").

[10]Under the proposed amendments, plaintiffs could rebut such presumption only by alleging "substantial and particularized" facts that show the director has a material interest in the transaction or a material relationship with a person that has a material interest in the transaction.

[11]*See* Bouchard, Andre G., *MFW Meets Its Match*, Directors & Boards (Sept. 13, 2024).

[12]The full definition of "fair as to the corporation" in the proposed amendments is "the act or transaction at issue, as a whole, is beneficial to the corporation, or its stockholders in their capacity, as such given the consideration paid to or received by the corporation or its stockholders or other benefit conferred on the corporation or its stockholders and taking into appropriate account whether the act or transaction meets both of the following: a. It is fair in terms of the fiduciary's dealings with the corporation. b. It is comparable to what might have been obtained in an arm's length transaction available to the corporation."

[13]For example, this would be particularly helpful in a situation where a hedge fund obtains holdup value by acquiring enough of the minority shares to block a deal subject to a MoM vote.

[14]*See* Cox, James D. *et al*., *The Paradox of Delaware's "Tools at Hand" Doctrine: An Empirical Investigation*, 75 Bus. Law. 2123 (2020).

[15]*See, e.g., Amalgamated Bank v. Yahoo! Inc.*, 132 A.3d 752 (Del. Ch. 2016) (abrogated on other grounds by, *Tiger v. Boast Apparel, Inc.*, 214 A.3d 933 (Del. 2019)) (granting access to electronic documents and emails stored in a director's personal email account).

[16]*KT4 Partners LLC v. Palantir Technologies Inc.*, 203 A.3d 738 (Del. 2019).

[17]The proposed amendments would define "books and records" to include corporate charters, bylaws, stockholder meeting minutes and actions by consent, written and electronic transmission communications to stockholders, board and committee meeting minutes (and records of action taken at such meetings), board and committee materials, annual financial statements, DGCL Section 122(18) contracts (*e.g.*, stockholder agreements) and director and officer independence questionnaires. Stockholder meeting minutes and actions by consent, written and electronic transmission communications to stockholders and annual financial statements would be required to be produced only for the three years preceding the date of the demand.

[18]*E.g., Tornetta v. Musk*, 326 A.3d 1203 (Del. Ch. 2024), judgment entered, 2024 WL 5120648 (Del. Ch. 2024) (approving a $345 million fee award to plaintiffs' counsel); *Police & Fire Retirement Sys. of the City of Detroit v. Musk*, C.A. No. 2020-0477 (Del. Ch. Jan. 8, 2025) (Transcript) (approving $176.16 million fee award to plaintiffs' attorneys); *In re Dell Technologies Inc. Class V Stockholders Litigation*, 326 A.3d 686 (Del. 2024) (approving a $266.7 million incentive fee award to plaintiffs' attorneys).

[19]*Tornetta v. Musk*, 326 A.3d 1203 (Del. Ch. 2024), judgment entered, 2024 WL 5120648 (Del. Ch. 2024).

[20]*See* Delaware Chancellor Whacks Elon Musk Again. The Latest in the *Tornetta v. Musk* Saga, ProfessorBainbridge.com (Dec. 2, 2024) (https://www.professorbainbridge.com/professorbainbridgecom/2024/12/delaware-chancellor-whacks-elon-musk-again-the-latest-

in-the-tornetta-v-musk-saga.html).

MAE CLAUSES, TARIFFS AND CROSS-BORDER M&A

By Sean Stevens, Sarah Gingrich, Neil Kravitz, Kareen Zimmer, Gesta Abols and Paul Blyschak

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Can tariffs trigger a "material adverse effect" ("MAE") in an M&A transaction? What aspects of an MAE analysis may be pivotal in deciding the point?

These questions are quickly becoming front of mind for North American dealmakers. History instructs that periods of abrupt macroeconomic uncertainty—see 9/11, the 2008 financial crisis, and the COVID-19 pandemic—increase the incidence of MAE disputes in M&A. The next chapter of similar turbulence may be upon us given the momentous shifts in trade dynamics being triggered by the new U.S. administration's policies.

In this rapidly evolving context, it is important that cross-border dealmakers appreciate three key differences between Delaware and Canadian law regarding MAE clauses. First, Canadian courts have retained the "unknown event" requirement. Second, Canadian courts have not imposed a "heavy burden" on a buyer claiming an MAE has occurred. Third, Canadian courts have interpreted and applied MAE clauses and "ordinary course of business" covenants together.

We briefly explain each of these divergences. We conclude with related practical considerations and drafting takeaways.

Fairstone and Modern Canadian MAE Law

Prior to the pandemic, Canadian judicial guidance regarding MAE clauses was thin and scattered. Almost 10 MAE rulings had been made, but almost all were low value disputes whose MAE analysis was relatively brief and unsophisticated. This changed in December 2020 with the issuance of *Fairstone Financial v. Duo Bank*.[1]

The dispute arose from the acquisition of a large consumer finance company for a price estimated to exceed C$1 billion. The deal was signed in mid-February 2020, *i.e.*, the very early stages of the COVID-19 pandemic. The target closing date was June 1, 2020, but five days earlier the buyer backed out, claiming the pandemic had triggered an MAE.

Citing the 2001 ruling of the Delaware Court of Chancery in *In re IBP Shareholders Litigation v. Tyson Foods*,[2] the Ontario court set a tripartite test whereby an MAE required "an unknown event, a threat to overall earnings potential and durational significance." While the Court held that each of these three elements had been met, it also held that three carve-outs within the MAE definition applied to defeat the buyer's MAE claim, including the "emergency" and "general market change" carve-outs. The court also held that the target had not been "disproportionately affected" by the pandemic such that the buyer could not rely on this qualifier to the carve-outs.

In reaching its MAE decision, the Ontario court relied much more on Delaware precedent than Canadian precedent, citing the former 25 times and the latter only 11 times. But while the majority of the Ontario court's MAE analysis aligns with Delaware, three key differences remain.

The "Unknown Event" Test Endures

Although *Fairstone* cited the Delaware Court of Chancery's landmark 2018 ruling in *Akorn, Inc. v. Fresenius Kabi AG*[3] more than any other U.S. or Canadian case, citing the decision nine times, the Ontario court quite curiously overlooked what is arguably *Akorn*'s most important aspect. Specifically, that *Akorn* definitively reversed almost two decades of Delaware law that had required an MAE to arise from an "unknown event."[4]

Fairstone retained the "unknown event" requirement in reliance on the 2001 Delaware ruling in *IBP v Tyson Foods*, as mentioned above. The Ontario court also found support for this approach in a 2002 ruling by a British Columbia court, which held as follows:

> In my view, the key to determining materiality and adversity in the circumstances of the case before me is the *knowledge* the defendant had as purchaser. If a fact or information were *already known* to the defendant, or if the defendant did not rely on it, the failure of the plaintiff to disclose it or information related to it would be of no consequence to the defendant's decision to buy and therefore would not be material or adverse to the defendant.[5]

A "Heavy Burden" vs. "From the Buyer's Perspective"

Delaware courts regularly specify that the buyer carries a "heavy burden" in seeking to prove an MAE has occurred. So too does Delaware caselaw and commentary regularly highlight policy concerns that weigh in the same direction and toward the protection of "deal certainty." The result is that *Akorn* remains the sole instance in which a Delaware court has held an MAE to have occurred.

Fairstone did not follow Delaware on this front. Indeed, in what can be interpreted as a conflicting approach, the Ontario court repeatedly instructed, rather ambiguously, that MAE clauses should be "interpreted from the buyer's perspective." The court also made other statements that can be interpreted as "buyer-friendly," including that, in deciding whether the pandemic met the "unknown event" requirement of an MAE (see above), it was inclined to give the buyer the "benefit of the doubt" on the issue. Lastly, whereas *Akorn* remains the sole instance of a Delaware court holding an MAE to have occurred, six Canadian decisions have done so (although, as previously mentioned, most of these were relatively low value disputes).[6]

All of this leaves the impression that Canadian MAE caselaw leans away from imposing a "heavy" burden on the buyer and, if anything, toward a more neutral or even somewhat "buyer-friendly" approach. That said, no firm conclusions can be drawn, and it is possible that Canadian courts may take a different approach where the MAE "carve-outs" don't clearly prevent a buyer from walking away.

MAE Clauses and Ordinary Course Covenants are Read Together

In *AB Stable v MAPS Hotels*,[7] another pandemic-era dispute, the Delaware Court of Chancery and Delaware Supreme Court held that, generally speaking, MAE clauses and "ordinary course of business" covenants should not be interpreted together. The courts explained that the two clauses "serve different purposes" and "guard against specific risks." Specifically, the courts held that an ordinary course covenant protects against a change in how the target operates while a MAE clause protects against a significant decline in the target's value. This did not mean that changed circumstances could not trigger both clauses. But it did mean that the "outcome of the analysis" and the "contractual results" flowing from the changed circumstances could be different such that the outcome under one clause did not "dictate the outcome" under the other clause.

By contrast, *Fairstone* and *Cineplex* (a second M&A dispute ruling issued in Ontario during the pandemic)[8] deemed it appropriate to read the two clauses together given the basic principle that "contracts should be read as a whole." Additional support for this approach was that a more general provision (*i.e.*, the ordinary course covenant) should yield to a more specific provision (*i.e.*, the MAE clause) and that the risk allocation set by the MAE clause should be preserved. Stated differently, as both clauses were triggered by the pandemic, and as the MAE clause expressly addressed emergencies and allocated such systemic risk to the buyer via the MAE definition's "carve-outs," the courts held the "ordinary course" covenant should not be read in a manner that conflicts with the MAE clause's risk allocation.

Key Practical and Drafting Takeaways

MAE clauses include multiple component parts that warrant specific consideration in connection with tariffs and the risks they may pose to a target. An exhaustive review of these is beyond the scope of this article, and so we have focused only on key differences between Delaware and Canadian MAE caselaw.

Regarding the fact Canadian courts have not imposed a "heavy burden" on a buyer who is claiming an MAE has occurred, we do not necessarily view this as a matter requiring attention by drafting, although the parties are of course free to do so. It is, however, a point that both buyer and seller should be alive to, should a potential MAE dispute actually arise.

Regarding the fact Canadian courts have interpreted and applied MAE clauses and ordinary course covenants together, it is arguable that different facts and drafting explain the different approach between *AB Stable*, on the one hand, and *Fairstone* and *Cineplex*, on the other hand, and this is the brief indication made in *Cineplex*. Other aspects of the decisions suggest a more principled rift between the courts, however, and that *Fairstone* did not follow *Akorn* on several key points is evidence of this. What is not debateable for M&A in Canada is that MAE clauses and ordinary course covenants should be considered in tandem and that, should the M&A parties desire otherwise, they can consider drafting toward that end.

Regarding the fact *Fairstone* retained an "unknown event" requirement, this raised a complicated question that could also be raised by the rapidly evolving and momentous shifts in North American trade and investment dynamics being triggered by the new U.S. administration's policies.

In *Fairstone*, when the deal was signed in mid-February 2020, the "novel coronavirus was already daily news in North America," but the official World Health Organization declaration of the pandemic and the issuance of sweeping "stay at home" orders by governments and business, which occurred in mid-March 2020, were still a month away. Most importantly, the exact "effect" on the target that the pandemic would go on to have was not yet foreseeable. The court therefore decided to give the buyer the "benefit of the doubt" on the point and ruled that COVID-19 satisfied the "unknown" event requirement. Stated differently, while COVID-19 was not "unknown" at the time of execution in mid-February 2020, the exact effect COVID-19 would go on to have on the target still remained "unknown."

There are clear parallels with the looming North American tariff war. Tariffs have been threatened (in some form) since late 2024 and therefore are not "unknown" in that sense. However, the exact "effect" they will have on the Canadian economy and any particular Canadian target remains debatable. The exact mix and substance of U.S. tariffs is also subject to change over time amid any prolonged trade war, should that eventuate. Retaliatory tariffs by Canada on U.S. exports are also capable of adversely impacting domestic business. The "unknown" event MAE requirement retained by *Fairstone* is therefore capable of raising very complex interpretive issues vis-à-vis tariffs depending on the circumstances. However, should a U.S. buyer wish to avoid these uncertainties, a potential solution is available: attempt to negotiate for a clarifying qualifier in the MAE definition to include known and/or foreseeable events.

ENDNOTES:

[1] *Fairstone Financial Holdings Inc. v. Duo Bank of Canada*, 2020 ONSC 7397 (CanLII) [*Fairstone*].

[2] *In re IBP, Inc. Shareholders Litigation*, 789 A.2d 14 (Del. Ch. 2001).

[3] 2018 Del. Ch. LEXIS 325 (Del. Ch. Oct. 1, 2018).

[4] *See* P. Lyons, M. Herman, S. Fain, P. Humphreys & A. Blacklock, "*Akorn v Fresenius*: Has a Material

Change in Delaware M&A Jurisprudence Occurred?" *The M&A Lawyer*, Vol. 22, Issue 10, November-December 2018.

[5]*Fairstone* at para. 66, quoting *Inmet Mining Corp. v. Homestake Canada Inc*., 2002 BCSC 61 (CanLII) at para. 128 (emphasis added).

[6]*See* Fasken's *Private M&A in Canada: Transactions and Litigation* (LexisNexis, 2024) at § 4.04[3][d]. Note that in four of these rulings, while the negative impact on the target was sufficient to constitute an MAE, the buyer was ultimately unable to rely on the MAE clause either because the "unknown event" element was not met or because one or more of the MAE definition's carve-outs applied.

[7]*AB Stable VIII LLC v. MAPS Hotels & Resorts One LLC*, C.A. No. 2020-0310-JTL (Del. Ch. Nov. 30, 2020), aff'd *AB Stable VIII LLC v. MAPS Hotels & Resorts One LLC*, 268 A.3d 198 (Del. Sup. Ct. Dec. 8, 2021) [collectively, *AB Stable*].

[8]*See Cineplex v. Cineworld* , 2021 ONSC 8016 (CanLII) [*Cineplex*].

DELAWARE SUPREME COURT OVERTURNS *TRIPADVISOR* DECISION—PROVIDING A CLEARER PATH FOR COMPANIES CONSIDERING REINCORPORATION FROM DELAWARE

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In a much-anticipated decision, *Maffei v. Palkon* ("*Tripadvisor*"),[1] the Delaware Supreme Court held that the Tripadvisor, Inc. board's decision to reincorporate the company from Delaware to Nevada is subject to the deferential business judgment rule standard of review—and not the significantly more onerous entire fairness standard.

The decision reverses the Court of Chancery's holding that Tripadvisor's reincorporation was subject to entire fairness review because the company's directors and controller may have received a material, non-ratable benefit from the transaction—namely, reduced exposure to litigation liability, as Nevada law may provide lower standards for fiduciaries as compared to Delaware law. The Court of Chancery also had suggested that, for the reincorporation to have been entirely fair, it may be that some form of consideration had to be paid to the minority stockholders to compensate them for the reduction in their "litigation rights" under Nevada law. Under business judgment review, however, the claims against the directors and the controller for breaches of fiduciary duty in approving the reincorporation almost certainly will be dismissed.

Key Points

- **A Delaware corporation's reincorporation to another state generally will be subject to judicial deference under the business judgment rule**. However, it may be subject to entire fairness review instead if the decision was not made on a "clear day"—that is, was made at a time that there was pending or threatened litigation against the directors or a controller or a specific transaction was contemplated.

- **The decision may stimulate further interest in considering reincorporation from Delaware**. While the Supreme Court's *Tripadvisor* decision facilitates reincorporation from Delaware, we continue to believe that the number of reincorporations will remain small and will continue to involve, primarily, controlled companies.

Background

In early 2023, the Tripadvisor board decided to reincorporate the company from Delaware to Nevada. The company disclosed to stockholders before the stockholder vote that the purposes of the reincorporation were to obtain the benefit of: lower fiduciary standards under Nevada law for directors and controllers; lower annual franchise fees; and improved conditions for recruiting corporate managers. Gregory Maffei owned 43% of the voting power of Tripadvisor, through his ownership of super-voting stock (and, for purposes of this case, he did not dispute that he controlled Tripadvisor). The stockholders approved the reincorporation—but only due to Maffei's vote, as very few minority stockholders voted in favor. Certain minority stockholders brought suit, claiming breach of fiduciary duties by the directors and Maffei in approving the reincorporation. At the pleading stage, the Court of Chancery held that the entire fairness standard of review presumptively applied and the reincorporation may not have been entirely fair.

The defendants sought, and in a rare move the Delaware Supreme Court agreed to hear, an interlocutory appeal. After briefing and oral argument, the defendants announced a proposed transaction that would simplify Tripadvisor's capital structure into a single class of shares *with no controlling stockholder*. The plaintiffs then moved to dismiss the appeal as moot, given the elimination of the controller. The Supreme Court held that the appeal was not moot; and, on the merits, that the applicable standard of judicial review was the business judgment rule rather than entire fairness.

Discussion

Court of Chancery ruling below. The Court of Chancery, at the pleading stage, based on the plaintiffs' allegations, ruled that: (i) it was reasonably conceivable that Nevada law imposes lower fiduciary standards for controllers and directors than Delaware; (ii) therefore, it was reasonably conceivable that Tripadvisor's proposed reincorporation would provide a material, non-ratable benefit to Tripadvisor's controller and directors, as they would be subject to lower fiduciary standards going forward, which would reduce their potential exposure to personal liability for their future actions; and (iii) therefore, the reincorporation was a conflicted transaction to which entire fairness presumptively applied.

Further, the Court of Chancery held that it was reasonably conceivable that the reincorporation was not entirely fair. With respect to the price prong of the entire fairness test, Vice Chancellor J. Travis Laster concluded that, after the reincorporation, the stockholders may not have "substantially the equivalent of what they had before"—specifically, they might have lesser "litigation rights" given the possibility that Nevada law imposes lower fiduciary standards for controllers and directors. With respect to the process prong, the Vice Chancellor noted that no procedural protections had been put in place for the minority stockholders, and that "the controller delivered the vote as the unaffiliated stockholders resoundingly rejected the [reincorporation]." Further, the Vice Chancellor suggested that, to meet entire fairness, a reincorporation might have to include payment of some kind of consideration to the minority stockholders to compensate them for the diminution of their litigation rights.

Appeal was not moot. The plaintiffs argued that, as Tripadvisor reported that it intended to engage in a transaction that would result in there being no controlling stockholder, the appeal was moot and the case should be dismissed. The Supreme Court held that the appeal was not moot—first, because the proposed transaction was "merely proposed and remain[ed] subject to conditions, including a stockholder vote"; and, second, because, even if the *controller*-related issues with respect to the reincorporation were eliminated, the issues as to the directors' conflicts remained.

No "material, non-ratable benefit" to the directors. The Supreme Court concluded that the directors did not obtain a material, non-ratable benefit from the reincorporation. Under existing law, the Supreme Court stated, in the *director* context, "in order to rebut the business judgment rule presumption, an interest must be subjectively material to the director"—in other words, "the alleged benefit must be significant enough as to make it improbable that the director could perform his fiduciary duties to the shareholders." The Supreme Court reasoned that providing protection to directors that would extinguish *existing or threatened litigation* against them, or that is provided in contemplation of a particular transaction, *could* provide a material, non-ratable benefit—but that, with respect to Tripadvisor, there was no litigation pending or threatened, and no transaction contemplated, as to which potential liability exposure would be affected by the reincorporation. The Supreme Court reasoned that the reincorporation's providing protection against *future liability exposure* was too "speculative and hypothetical" automatically to cast doubt on the directors' independence in deciding whether to reincorporate.

No "material, non-ratable benefit" to the controller. The Supreme Court concluded that the controller also did not obtain a material, non-ratable benefit from the reincorporation. Under existing law, the Supreme Court stated, in the *controller* context, "the mere fact that a controller may be better positioned after a transaction does not necessarily mean that the controller received a non-ratable benefit." The court noted *Williams v. Geier*[2]—where a recapitalization involved a charter amendment that provided for a form of tenure voting. While the controlling stockholders in that case reaped a benefit from the charter amendment, the Supreme Court affirmed application of business judgment review—as no non-ratable benefit had accrued to the controlling stockholders "on the face of the Recapitalization." In other words, the controlling stockholders received the same benefit as the other stockholders, "although the dynamics of how the Plan would work in practice had the effect of strengthening the [controller's] control."

Approval on a "clear day." The Supreme Court emphasized that Tripadvisor approved the reincorporation at a time there were no claims against the controller or the directors—the proverbial "clear day." The court emphasized: "The hypothetical and contingent impact of Nevada law on unspecified corporate actions that may or may not occur in the future is too speculative to constitute a material, non-ratable benefit triggering entire fairness review." The plaintiffs had not "alleged anything more than speculation about what potential liabilities Defendants may face in the future." The court observed that boards routinely obtain D&O insurance, provide directors with rights to indemnification and advancement of expenses, and provide for director exculpation under DGCL Section 102(b)(7)—each of which reduces the risk of directors liability exposure in *future* litigation for *future* conduct, but none of which have been viewed by Delaware courts as providing a material, non-ratable benefit invoking entire fairness review (so long as the action did not limit directors' liability for *past* conduct).

Comity issue. The Supreme Court stated that comity concerns were not "an independent ground" for reversing the Court of Chancery's *Tripadvisor* decision, but that reversal "furthers the goals of comity by declining to engage in a cost-benefit analysis of the Delaware and Nevada corporate governance regimes." The Supreme Court stressed that, although the lower court focused on a possible diminution of minority stockholders' "litigation rights" under Nevada law as compared to Delaware law, "the overall integrated corporate governance structure" would be relevant in evaluating the impact of reincorporation of the stockholders. The Supreme Court wrote: "[C]ourts are ill-equipped to quantify the costs and benefits of one state's corporate governance regime over another's" and "should be cautious about second-guessing the judgments of the directors as to how best to evaluate and weigh the various competing considerations as such factors might apply to a specific corporation . . . [particularly] given that none of these features is static, including the statutory schemes at issue and their related case law developments."

Our Observations

- **Controlled companies**. To date, all of the corporations that have actually reincorporated from Delaware, citing Delaware law issues as the reason, have been controlled companies. Discussion about potential reincorporation also has occurred at noncontrolled companies. However, controllers have been most focused on the issue—due to Delaware decisions they have viewed as reflecting heightened judicial skepticism of their role and expanded potential liability for them. (In addition, of course, controlled companies do not face the same issues as non-controlled companies in obtaining the stockholder approval needed for a reincorporation.) We expect that it will continue to be primarily controlled companies that seriously consider reincorporation, or actually reincorporate, from Delaware.

- **Small number of reincorporations from Delaware**. Our research indicates that, from 2021 through November 2024, only eight Delaware corporations, citing concerns about Delaware law, reincorporated to other states—four to Nevada (including Tripadvisor) and two to Texas. Each of these was a controlled company. In recent days, two controlled companies have reported intentions to reincorporate from Delaware—Meta (to Texas) and Pershing Square (to Nevada).

- **Facts and circumstances**. While *Tripadvisor* generally establishes that the court will defer to a board's business judgment in deciding where the corporation should be incorporated, a reincorporation still could be subject to entire fairness review—if it would restrict liability for directors or a controller with respect to their past conduct or a contemplated transaction; or if there are other duty of loyalty issues with respect to the directors or a controller. It remains to be seen, under *Tripadvisor*, to what extent, before a reincorporation, a claim would have to have been already actually and explicitly threatened, or a post-reincorporation transaction would have to have been actually and explicitly proposed or contemplated, for the court to view the reincorporation as having not been adopted on a "clear day" and therefore subject to entire fairness review.

- **Comparisons with Delaware law**. Most reincorporations from Delaware have been to Nevada, with Texas a distant second. Nevada law, while still evolving and subject to judicial interpretation, on its face appears to (i) impose no *Revlon* duties on sale of a company, impose no heightened duties with respect to the adoption of defensive tactics, and largely reject the concept of entire fairness in conflicted controller transactions; (ii) exculpate directors and officers for any breach of fiduciary duty (including the duty of loyalty), excepting only breaches involving "intentional misconduct, fraud or a knowing violation of law"; and (iii) provide stockholders with relatively limited access to corporate books and records (even when corporate wrongdoing is suspected). It is also to be noted that Nevada judges are elected; and jury trials are available for business cases. We note that Texas law appears to be more similar to Delaware law, albeit far less developed.

Practice Points

- **Establishing there is no material, non-ratable benefit**. For directors and controllers to establish that they are not obtaining a material, non-ratable benefit in a reincorporation from Delaware, they should approve the reincorporation on a "clear day" (*i.e.*, when there is no litigation pending or threatened against them, and no specific post-reincorporation transaction contemplated). Also, they could consider (i) committing to have claims relating to past conduct decided under Delaware law; and/or (ii) arguing that the new state does not have materially lower fiduciary standards (or other legal principles) such that potential liability for past conduct would be affected.

- **Disclosure to stockholders in connection with a reincorporation**. (i) Generally, where applicable, a company should consider disclosing that lower fiduciary standards may be applicable in the new state—so that stockholders are armed with this potential disadvantage to them when voting. (ii) A company should consider disclosing, where possible, the ways in which the corporation and its stockholders *as a whole* may benefit from the reincorporation—for example, the company may be less vulnerable to product liability suits under the legal regime in the new state; the move may bring the corporation to the state where its operations are located; or the new state's political and cultural environment may align better with the corporation's core values. (iii) We note that certain typically-cited purposes for reincorporation may not be convincing to the court. In *Tripadvisor*, the Court of Chancery stated that the purported benefit of lower franchise fees in the new state was likely not material given the size of the company; and that the purported benefit in recruiting directors and management was not a separate benefit from obtaining lower fiduciary standards as it was simply a product of the lower litigation exposure. (iv) Where accurate, a company should state that there is no existing litigation or threatened claims, and no transaction contemplated, that would be affected by the reincorporation.

- **Key considerations when reincorporating**. (i) The likely reaction of institutional investors and proxy firms, as well as any possible impact on the stock (or an IPO) price, should be considered. (ii) A company going public could consider including in its organizational documents provisions supporting an ability to reincorporate to a different state in the future. (iii) A controlled company should consider possible process protections for the minority stockholders, such as utilizing a special committee of independent directors. (iv) Consideration could be given to obtaining expert advice with respect to the legal, financial, or other effects of the reincorporation. (v) In all cases, the board should consider not only the potential for reduced liability exposure, but the new state's overall legal and governance structure—including the structure of the court system; the development of the body of law respecting corporate matters; the predictability of judicial decisions with respect to corporate matters; judges', and the corporate bar's, expertise in handling corporate disputes; investors' familiarity with and confidence in the legal and corporate governance regimes; the process for proposal and adoption of legislative changes; and the secretary of state's track record in facilitating corporate filings.

ENDNOTES:

[1] *Maffei v. Palkon*, CA No. 2023-0449 (Del. Feb. 4, 2025).

[2] *Williams v. Geier*, 671 A.2d 1368, 1377 (Del. 1996).

SHIFTING RULES OF ENGAGEMENT: THE IMPACT OF RECENT SEC GUIDANCE ON 13G ELIGIBILITY, RULE 14A-8 SHAREHOLDER PROPOSALS AND EXEMPT SOLICITATIONS

By Scott A. Barshay, Carmen X. Lu, Frances F. Mi and Kyle T. Seifried

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The Staff in the Division of Corporation Finance at the U.S. Securities and Exchange Commission has issued three new sets of guidance that may influence and potentially reshape how shareholders engage with companies going forward.

Guidance on 13G Eligibility

On February 11, the Staff issued new compliance and disclosure guidance[1] on the eligibility of shareholders to report their ownership interests on Schedule 13G. The new guidance provides that the Staff's assessment of a shareholder's 13G eligibility will consider the **subject matter** of such shareholder's engagement with management and the **context** in which such engagement occurs. A shareholder "who discusses with management its views on a particular topic and how its views may inform its voting decisions, without more, would not be disqualified from reporting on a Schedule 13G." However, a shareholder who takes the following actions could be disqualified if they:

- recommend that the company remove its staggered board, switch to a majority voting standard in uncontested director elections, eliminate its poison pill plan, change its executive compensation practices or undertake specific actions on a social, environmental or political policy and, as a means of pressuring the issuer to adopt the recommendation, explicitly or implicitly condition their support of one or more of the issuer's director nominees at the next director election on the issuer's adoption of its recommendation; or

- discuss with management its voting policy on a particular topic and how the issuer fails to meet the shareholder's expectations on such topic, and, to apply pressure on management, state or imply during any such discussions that they will not support one or more of the issuer's director nominees at the next director election unless management makes changes to align with the shareholder's expectations.

Potential Impact

The Staff's recent guidance on 13G eligibility may call into question the viability of certain institutional investor stewardship practices. Institutional shareholders have, from time to time, leveraged their proxy voting power to influence governance practices within companies. Such efforts have been supported by publicly disclosed proxy voting policies and vote bulletins which outline circumstances where an institutional shareholder may vote against directors. In recent years, it has also become an increasingly common practice for stewardship teams to engage with management and directors prior to and following annual meetings to discuss specific matters of concern relating to corporate governance and executive compensation.

As institutional investors look to preserve their Schedule 13G eligibility, there may be changes in the tone, substance and timing of engagements with and communications from stewardship teams. Such changes could make it more difficult for companies to have candid conversations with their key investors on issues of concern. The changes may also make it more difficult for companies to pinpoint the issues that are of priority to their largest investors and are most likely to trigger an adverse vote against directors. As investor priorities and perspectives evolve, companies may also have more difficulty tracking such changes if publicly disclosed proxy voting-related guidance become less frequent or detailed.

The impact of recent guidance changes could be particularly noticeable in contested situations where the perspectives of institutional investors may become more "muted" relative to the views of activist shareholders and proxy advisors who will not be impacted by the latest 13G guidance. In those circumstances, companies could find themselves flying blind if they have not already developed robust relationships with their key investors and strategies to discern their perspectives and the meaning of any indirect messaging. Developing these kinds of robust relationships and strategies can be very useful going forward.

Revised Guidance on Rule 14a-8 Shareholder Proposals

On February 12, the Staff rescinded Staff Legal Bulletin No. 14L ("SLB 14L"), which broadly permitted Rule 14a-8 shareholder proposals relating to "ESG" matters of no economic significance to the target company and issued Staff Legal Bulletin No. 14M ("SLB 14M")[2] in its stead. The adoption of SLB 14M and the recission of SLB 14L mark a direct reversal of policies adopted under former SEC Chair Gary Gensler.

SLB 14M revises guidance on the excludability of Rule 14a-8 shareholder proposals on the basis that a proposal lacks "economic relevance" or is related to the "ordinary business" of a company. Previously, SLB 14L provided that shareholder proposals which lacked "economic relevance" or were related to the "ordinary business" of a company could not be excluded if they concerned a significant social policy matter, regardless of whether such matter was significant to the target company. Going forward, under SLB 14M, the Staff will be taking a company-specific approach and shareholder proponents who raise "social or ethical issues" in their proposal must "tie those matters to a significant effect on the company's business." Board analysis on the significance of such matters to a company will also be welcomed again by the Staff to assist in the Staff's analysis of no-action requests to exclude shareholder proposals.

In addition, new SLB 14M reinstates guidance making it easier for companies to exclude shareholder proposals that seek to "micromanage" them. That "anti-micromanagement" guidance had previously been rescinded by the Gensler Staff's SLB 14L. The changes signal that the Staff will now be prepared to take a more expansive view on what proposals may be excluded on the basis of "micromanagement." Amendments to Rule 14a-8 proposed in 2022 but never adopted, and which would have further narrowed the bases for companies to exclude shareholder proposals, have also been placed on hold indefinitely.

Potential Impact

The latest guidance on Rule 14a-8 will make it significantly easier for companies to exclude shareholder proposals from special interest groups with environmental or social agendas. Support for proposals focusing on environmental or social issues have already noticeably declined during the past two proxy seasons as investors weigh the costs and benefits of such proposals.

Special interest shareholder proponents may begin to look to alternative avenues to engage with companies. Over the past year, we have observed social media becoming a platform for pressuring companies on social issues. We have also observed shareholders bypassing the constraints of Rule 14a-8 and turning to Rule 14a-4 to submit multiple shareholder proposals at companies. What is unlikely to happen, however, is an increase in proxy contests relating to non-economic social or environmental issues such as those launched against Starbucks, McDonald's and Kroger in recent years. Such campaigns are costly, and like shareholder proposals on environmental and social issues, have not gained traction with the broader shareholder base.

While the updated Staff guidance will likely narrow opportunities for shareholders to use Rule 14a-8 shareholder proposals to influence company policy, the appetite for engagement and change among shareholders focused on environmental and social issues has not diminished. Consequently, we may see such shareholders increasingly use third-party engagement platforms or undertake direct outreach to boards and management as part of efforts to influence corporate policy.

Guidance on the Use of Exempt Solicitation Notices

On January 27, the Staff issued new and revised CD&Is for Notices of Exempt Solicitation.[3] Among other changes, the CD&Is:

- require shareholders who own less than $5 million of the class of subject securities and are consequently submitting a voluntary Notice of Exempt Solicitation to clearly state such fact on the cover of such notice;
- require shareholders to disseminate written soliciting materials to security holders before filing such materials under the cover of a Notice of Exempt Solicitation with the Commission;
- reiterate that only written communications that constitute a "solicitation" under the Exchange Act[4] should be submitted under the cover of a Notice of Exempt Solicitation; and
- apply Rule 14a-9, which prohibits materially false or misleading statements, to materials filed under the cover of a Notice of Exempt Solicitation.

Potential Impact

The latest CD&Is on the use of Notices of Exempt Solicitation appear to respond to growing concerns that such notices have inadvertently become a platform for shareholders, particularly shareholder proponents who have submitted Rule 14a-8 shareholder proposals, to engage in "public debate" with companies in the days and weeks leading up to the annual meeting. Unlike Rule 14a-8, which restricts the length of a shareholder's supporting statement to 500 words, exempt solicitation notices do not impose word count limits. Consequently, for shareholders with limited resources, exempt solicitations have become an attractive avenue to garner the attention of not only the company but also institutional investors and proxy advisors who often review such filings prior to making their voting decisions.

The latest Staff guidance sends a clear signal that the Commission under incoming Chair Paul Atkins will adopt policy positions that are meaningfully more "pro-company" than the approaches pursued under former Chair Gary Gensler. As companies respond to these shifting policies, they would be well advised to ensure that they remain closely attuned to institutional investor expectations given the significant proxy voting influence they continue to wield at many companies.

ENDNOTES:

[1]https://www.sec.gov/about/divisions-offices/division-corporation-finance/exchange-act-sections-13d-13g-regulation-13d-g-beneficial-ownership-reporting-021125.

[2]https://www.sec.gov/about/shareholder-proposals-staff-legal-bulletin-no-14m-cf.

[3]https://www.sec.gov/about/divisions-offices/division-corporation-finance/proxy-rules-schedules-14a14c-notice-012725.

[4]The Exchange Act defines "solicitations" to include, subject to certain exceptions: (i) any request for a proxy whether or not accompanied by or included in a form of proxy; (ii) any request to execute or not to execute, or to revoke, a proxy; or (iii) the furnishing of a form of proxy or other communication to security holders under circumstances reasonably calculated to result in the procurement, withholding or revocation of a proxy.

FROM THE EDITOR

Tumult in Delaware

In our March issue, *The M&A Lawyer* takes a look at a situation that's been underway for some time—growing concerns that Delaware could possibly lose its status as a favored state in which corporations domicile, due to recent decisions by Delaware courts.

As Paul Weiss' Scott Barshay (a member of *The M&A Lawyer*'s editorial board) and Andre Bouchard write, "for well over half a century, Delaware has taken a balanced and predictable approach to corporation governance and resolving business disputes . . . But over the past year, boards of directors of public companies and key stockholders of companies about to go public have been reconsidering whether to domicile in Delaware."

Such court decisions include those which have called into question several long-established practices related to stockholder and merger agreements. "Others broke new ground on a range of other issues, including standards of review for controlling stockholder and other interested transactions and the ability of plaintiffs' lawyers to obtain an ever-expanding set of corporate documents to fish for reasons to sue public companies."

These rulings have prompted legislative action in the Delaware state government, which recently proposed amendments to the Delaware General Corporation Law ("DGCL"). These amendments would, as Barshay and Bouchard write, "restore greater clarity and predictability in structuring controller and other interested transactions and to protect against frivolous litigation by narrowing stockholder access to corporate books and records."

"While it is still in the early stages and changes to the bill may be proposed as the legislative process moves forward, we believe the amendments in their current form make a great deal of sense and would significantly bolster confidence in Delaware among key stakeholders," the authors write.

Also in this issue, Fried Frank lawyers examine the recent *Maffei v. Palkon* ("*Tripadvisor*") decision, in which the Delaware Supreme Court held that the Tripadvisor board's decision to reincorporate the company from Delaware to Nevada "is subject to the deferential business judgment rule standard of review—and not the significantly more onerous entire fairness standard." The decision reverses the Court of Chancery's ruling that the reincorporation was subject to entire fairness review.

As the authors write, "the decision may stimulate further interest in considering reincorporation from Delaware." But while the *Tripadvisor* decision facilitates such a reincorporation, "we continue to believe that the number of reincorporations will remain small and will continue to involve, primarily, controlled companies."

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