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■ SECURITIES DISCLOSURE

Accounting and Reporting Considerations for Warrants Issued by SPACs

The SEC Staff has issued a statement on accounting and reporting considerations for warrants issued by SPACs that could cause certain warrants to be classified as a liability rather than equity under US GAAP. In which case, previously filed financial statements my need to be revised or restated.

By Mark S. Bergman, David S. Huntington, Raphael M. Russo, and David A. Curtis

Since John Coates, Acting Director of the SEC Division of Corporation Finance, and Paul Munter, Acting SEC Chief Accountant, published their Staff Statement on Accounting and Reporting Considerations for Warrants Issued by special purpose acquisition companies (SPACs) on April 12, 2021, SPAC issuers and their advisers have been evaluating how best to address the issues raised. The Staff is of the view that certain common SPAC warrant terms could cause SPAC warrants to be classified as a liability rather than equity under US GAAP, in which case previously filed financial statements may need to be revised or restated. The impact of the Staff Statement on any particular SPAC will depend on the terms of each SPAC's warrants and such SPAC's specific circumstances.

What Warrant Terms Could Cause the Warrants to be Treated as a Liability Instead of Equity?

Indexation

The Staff Statement states that if the warrants provide for potential changes to the settlement amounts depending on the characteristics of the holder of the warrant (*e.g.*, private warrants vs. public warrants), such provisions would preclude the warrants from being considered indexed to the entity's stock, and the warrants should be classified as a liability measured at fair value, with changes in fair value reported each period in earnings.[1]

Virtually all existing SPACs with a warrant structure provide that upon a transfer the private warrants lose certain special features (*e.g.*, the non-redeemable feature) and become fungible with the public warrants. Based on discussions with certain of the SPAC accounting firms, it appears that the combination of the special features of the private warrants and their fungibility with the public warrants results in an indexation issue that will cause virtually all private warrants in existing SPAC structures to be reclassified as liabilities for accounting purposes. This already has resulted in numerous SPACs restating their financial statements in their annual reports (and any quarterly reports filed since their last annual report).

Tender/Exchange Offer Provisions

The Staff Statement also states that if the warrants provide for net cash settlement upon the occurrence of an event outside of the entity's control, and in such circumstance not all holders of the underlying equity securities would receive cash, for example, if the warrants provide that upon the acceptance of a tender or exchange offer by more than 50 percent of the holders of the outstanding common stock, the holders of the warrants would be entitled to receive cash for all their warrants whereas holders of common stock may receive a mix of consideration or may not have all their shares of common stock accepted if the offer is for less than all of the outstanding shares of common stock, then the warrants should be classified as

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a liability measured at fair value, with changes in fair value reported each period in earnings.

What Are the Next Steps?

Registrants should consult with their auditors and legal advisors to evaluate the terms of their warrants and determine whether the warrants need to be reclassified as a liability. If so, the next steps may vary depending on where the SPAC is in its lifecycle and the materiality of the accounting error. In all cases, registrants should take care not to selectively disclose material non-public information.

Pre-SPAC IPO

Pre-IPO SPACs will have the option of revising the terms of their warrants to ensure that they may be classified as equity or revising their registration statement disclosures to reflect the classification of the warrants as a liability. SPACs should anticipate that the process of confirming with the Staff the accounting treatment for alternative warrant structures to avoid classification of warrants as a liability may take some time, at least for the early movers. SPACs also should review their risk factor disclosures and, if not already included, consider adding a risk factor that similar reclassifications, based on updated or revised accounting guidance or interpretations, could occur in the future.

All Stages Post-SPAC IPO

Registrants will need to evaluate whether their warrants include the provisions highlighted in the Staff Statement and, if applicable, consider whether a reclassification of the warrants as a liability is appropriate. Following a decision to reclassify the warrants, the registrant will need to evaluate the materiality of the accounting error in accordance with Staff Accounting Bulletin (SAB) No. 99—Materiality (codified in SAB Topic 1, Section M–*Materiality*). A conclusion that the error is material within the meaning of SAB No. 99 will necessitate the restatement of previously-issued financial statements. However, each SPAC will need to conduct its own analysis and certain SPACs (for example, those with lower warrant coverage) may be able to determine that the reclassification is not material.

SPACs also should review their risk factor disclosures and, if not already included, consider adding a risk factor that similar reclassifications based on updated or revised accounting guidance or interpretations could occur in the future.

Post-SPAC IPO/Pre de-SPAC Agreement

Not material: If the registrant determines that the error is not material, then it would revise its financial statements in its next periodic report on Form 10-Q or Form 10-K.

Material: If the registrant determines that the error is material, it will need to file an Item 4.02 Form 8-K (Non-Reliance on Previously Issued Financial Statements or a Related Audit Report or Completed Interim Review) and restate the previously-issued financial statements, including filing amended Form 10-Ks and Form 10-Qs, as applicable.

Post de-SPAC Agreement Signing/Pre-Effectiveness of Business Combination Registration Statement/Definitive Merger Proxy

We understand that the SEC will not declare registration statements effective or clear merger proxy statements until the registrant has made a determination regarding materiality and restatement, and appropriate filings have been made. This will add a delay to the filing and review of registration and proxy statements (and amendments thereto).

Not material: We expect that the registrant would need to restate the most recent historical period information included in the de-SPAC registration or merger proxy statement on amended Forms 10-K and 10-Q prior to its next registration or merger proxy statement filing. In order to facilitate the processing of pending submissions, the Staff has encouraged registrants to provide, via EDGAR, a written representation that such accounting error(s) are not material to the required financial statements and disclosures included in pending submissions and filings.

Material: The registrant will need to file an Item 4.02 Form 8-K (Non-Reliance on Previously Issued Financial Statements or a Related Audit Report or Completed Interim Review) and restate the previously-issued financial statements before proceeding with any further registration or proxy statement filings (which too would require amendment to reflect the restatement).

Post-Effectiveness/Pre-Shareholder Meeting

In addition to analyzing the materiality of the accounting error for the purposes of determining whether to restate previously-issued financials, the registrant will need to evaluate the materiality of the financial statement changes to the investment decision to vote with respect to the transaction. Depending on the outcome of its materiality analysis, the registrant may need to file a Form 8-K to explain the change, or revise, reprint, and re-mail the documents to shareholders.

Not material: If the registrant determines that the error is not material, then it would revise its financial statements in its next periodic report on Form 10-Q or Form 10-K. SPACs which have not yet held their meeting should consider providing shareholders with disclosure around the potential impact of the revisions on a Form 8-K prior to the shareholders meeting.

Material: If the registrant determines that the error is material, it will need to file an Item 4.02 Form 8-K (Non-Reliance on Previously Issued Financial Statements or a Related Audit Report or Completed Interim Review) and restate the previously-issued financial statements. Each SPAC will need to evaluate the effect of this on its meeting materials to consider whether qualitative disclosure about the potential impact on the financial statements can be provided on a Form 8-K or the changes would require more significant amendments to the effective registration statement or definitive proxy statement. There are potential scenarios where additional disclosure would require a re-mailing of the materials.

Post-Shareholder Meeting

Within four business days of closing a de-SPAC transaction, the combined company is required to file a "Super Form 8-K" which includes current financial statements. Parties should consider whether to delay the closing of the transaction to ensure that there is sufficient time to assess the materiality of the accounting error and prepare revised or restated financial statements, as necessary, so that accurate financial statements are filed with the Form 8-K.

Not material: If the registrant determines that the error is not material, then it would revise its financial statements in its next periodic report on Form 10-Q or Form 10-K, which would then be included in the post-closing Form 8-K.

Material: If the registrant determines that the error is material, it will need to file an Item 4.02 Form 8-K (Non-Reliance on Previously Issued Financial Statements or a Related Audit Report or Completed Interim Review) and restate the previously-issued financial statements prior to including them in the post-closing Form 8-K.

Post de-SPAC Transaction Closing

Following a de-SPAC transaction, the resulting public company inherits the SPAC warrants and may also be affected by this issue.

Not material: If the registrant determines that the error is not material, then it would revise its financial statements in its next periodic report on Form 10-Q or Form 10-K.

Material: If the registrant determines that the error is material, then it will need to file an Item 4.02 Form 8-K (Non-Reliance on Previously Issued Financial Statements or a Related Audit Report or Completed Interim Review) and restate the previously-issued financial statements. Registrants will need to consider how this determination will affect any near-term plans to raise capital in the public markets and any existing "shelf" registration statements.

Internal Control Over Financial Reporting and Disclosure Controls and Procedures

Regardless of SPAC lifecycle stage or materiality, the registrant should consider evaluating its internal control over financial reporting and disclosure controls and procedures to determine whether the controls are adequate in light of the error. The registrant should consider whether its prior evaluations should be revised in any amended filings that will need to be made, and should analyze whether there is a control deficiency and the severity of any control deficiency identified. The Staff Statement notes that the evaluation of the severity of a control deficiency should consider the potential misstatement arising from the deficiencies, not just the actual misstatement that occurred or whether it was material. Where applicable, the registrant's auditor also will need to evaluate management's assessment.

Note

1. This treatment results because the variables (the holders' characteristics) are not inputs to the fair value of a fixed-for-fixed forward or option on equity shares under US GAAP. If the warrant terms provide for changes based on other variables that also are not inputs to the fair value of a fixed-for-fixed forward or option on equity shares, such provisions also would preclude the warrants from being considered indexed to the underlying stock, and result in the classification of the warrants as a liability.

DIRECTOR AND OFFICER LIABILITY

Delaware Courts Issue Series of Pro-Policyholder D&O Insurance Decisions

The Delaware court have issued several important decisions favoring policyholders in D&O coverage litigation, including a Delaware Supreme Court decision on choice of law, insurability and allocation.

By Mark F. Rosenberg and Nicholas F. Menillo

On March 3, 2021, the Delaware Supreme Court in *RSUI Indemnity Co.* v. *Murdock*[1] issued an important decision concerning various coverage issues under directors and officers liability (D&O) policies. The decision ends years of litigation (the *Dole* litigation) concerning insurer obligations for settlements of: (1) litigation in which two executives of Dole Food Co. (Dole) were found to have fraudulently induced Dole to permit one of them to take the company private at an unfairly low price; and (2) a follow-on securities fraud suit based on the same wrongful conduct. As discussed in more detail below, the Court held that

1. The D&O policy was governed by Delaware law because Dole was incorporated in Delaware—even though its principal place of business was in California and the policies were issued in California;
2. Breaches of fiduciary duty, including fraud, by a company's officers and directors are not uninsurable as a matter of Delaware public policy; and
3. An allocation provision in the policy requiring the parties to use their best efforts to agree on allocation as between insured and uninsured parties and matters, taking into account relative financial and legal exposures, did not apply because (a) the parties neither made an effort to agree, nor agreed, on allocation, and (b) the provision is inconsistent with the overall coverage of the policy.

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This decision followed a series of lower court decisions containing other important rulings which the Delaware Supreme Court did not review. These included holdings concerning: (1) the ability of an insured to obtain coverage for a settlement in the full amount of the underlying claim after having been found guilty after trial of fraud; (2) the effect on coverage of entering into a settlement without the insurer's consent; and (3) the ability of an insured to refuse to cooperate with insurer requests that call for privileged information.

In light of the large number of corporations that are incorporated in Delaware and the numerous lawsuits that allege securities and common law fraud against such corporations and their officers and directors, the Delaware Supreme Court decision, as well as the lower court rulings left undisturbed by that decision, have significant implications both for insureds and insurers, including:

1. The Delaware Supreme Court's analysis suggests that Delaware public policy imposes no restraint at all on the scope of D&O insurance coverage. D&O insurers thus must rely on the language of their policies, and not public policy, to exclude coverage for fraudulent conduct in Delaware.
2. In certain other states, claims arising from fraud are uninsurable as a matter of public policy. Likewise, certain other types of claims (such as for punitive damages or disgorgement) are insurable in Delaware but uninsurable in certain other states. In light of the Delaware

Supreme Court's choice-of-law analysis, insurers may race to bring coverage actions in states other than Delaware in an attempt to avoid the application of Delaware law.

3. Under the Delaware Superior Court's analysis, coverage may be available for a settlement in which the insureds agree to pay the full amount of liability after having been found guilty of fraud at trial. As a corollary, it may be considered unreasonable for an insurer to refuse to consent to such a settlement. This provides an incentive for insureds to try to delay final judgment and negotiate a settlement even after being found guilty of fraud at trial. Other courts, such as the US Court of Appeals for the Seventh Circuit, have held that coverage is unavailable in similar circumstances.
4. Under the Delaware Superior Court's analysis, provisions in D&O policies requiring "reasonable" cooperation do not necessarily require insureds to provide privileged information to insurers.
5. To combat the Delaware courts' pro-insured decisions, insurers may seek to amend their D&O policies, including by strengthening their fraud exclusions, clarifying how loss is to be allocated as between insured and uninsured matters and actors, and including express choice-of-law provisions for a law other than that of Delaware.

Background

David Murdock's Acquisition of Dole's Stock

Dole is one of the largest producers of fruits and vegetables in the world. In November 2013, it went private through a single-step merger transaction in which David H. Murdock, Dole's then-Chairman and Chief Executive Officer, acquired all of Dole's common stock that he did not already own at a price of $13.50 per share,[2] totaling approximately $1.2 billion. Before the transaction, Murdock had owned approximately 40 percent of Dole's common stock.[3] The transaction was negotiated with a Special Committee of Dole and approved by a narrow majority—50.9 percent—of disinterested stockholders. The transaction closed November 1, 2013.[4]

Stockholder Litigation Challenging the Fairness of the Transaction

Before the transaction closed, a group of Dole stockholders who owned shares at the time of the going private transaction brought a class action in the Delaware Court of Chancery alleging that Murdock and C. Michael Carter (Dole's President, Chief Operating Officer, and General Counsel) had breached their fiduciary duties, including their duty of loyalty, by making intentionally false statements to the Dole Special Committee[5] negotiating the proposed transaction and taking other improper actions to fraudulently induce Dole to agree to the transaction at an unfairly low price.[6] This case was subsequently consolidated with a separate action by another group of stockholders in the Chancery Court disputing the adequacy of the merger's share price and requesting the court to appraise the fair value of the stock at the time of the merger.[7] These two consolidated actions are collectively referred to here as the "Stockholder Litigation."

Post-Trial Ruling that Murdock and Carter Committed Fraud

In a lengthy August 27, 2015 memorandum opinion, issued after a nine-day bench trial, the Chancery Court (Laster, V.C.) held that Murdock and Carter had breached their fiduciary duties

> through a series of intentional, unfair, and fraudulent actions that, among other things, drove down Dole's pre-merger stock price, undermining it as a measure of value and hampering the Special Committee's negotiating position.[8]

The court identified a number of fraudulent statements that Murdock and Carter made to the market and to the Special Committee.[9] The court found that Murdock and Carter's conduct had "reduced the ultimate deal price by 16.9 percent,"[10] and held Murdock and Carter jointly liable for approximately $148 million in damages, representing $2.74 per share.[11] In addition to holding Murdock and Carter liable, the court also found DFC Holdings, LLC (a special purpose vehicle used by Murdock to acquire the shares of Dole) jointly and severally liable with Murdock and Carter.[12]

Settlement of the Stockholder Litigation

After the Chancery Court issued its memorandum opinion, but before judgment was entered in the case, Murdock and Carter negotiated a settlement with plaintiffs pursuant to which Murdock agreed to pay the full $148 million amount awarded by the Chancery Court, plus interest.[13] The insurers were asked to provide consent to the settlement, but, instead of doing so, they requested certain information, pursuant to the cooperation requirements of the policies, in connection with the insureds' requests for consent.[14] The insureds then executed the settlement without obtaining insurer consent.[15] The Chancery Court approved the settlement in February 2016.[16]

The San Antonio Action

In December 2015, the San Antonio Fire & Police Pension Fund, which had disposed of its Dole shares prior to the effective date of the going private transaction and, therefore, was not a party to the initial Stockholder Litigation, instituted a securities fraud class action in the US District Court for the District of Delaware against Dole, Murdock, Carter, and DFC on behalf of a putative class of individuals who sold their stock in Dole between January 2 and October 31, 2013 (San Antonio Action).[17] Citing the trial court's findings in the Stockholder Litigation, plaintiffs alleged that they suffered financial losses by selling Dole stock at artificially reduced prices as a result of Murdock and Carter's false and misleading statements in violation of the Securities Exchange Act of 1934.[18] The San Antonio Action was settled in January 2017 for $74 million.[19] Again, the defendants informed the insurers of their intent to settle, and the terms of the settlement, but the insurers did not provide their consent.[20]

Dole's D&O Policies

During the relevant period, Dole's D&O insurers included a primary insurer (AXIS Insurance Company) and eight "excess" insurers (including RSUI Indemnity Company) providing a total of $85 million in policy limits. The excess policies each followed the terms and conditions of the AXIS policy but were available for use only after all underlying insurance has been exhausted.[21] DFC was not an insured, and Murdock and Carter were insured only for acts taken in their capacity as a Dole officer or director.[22]

The policies contained generally customary terms, including, among other things: (1) a conduct exclusion for fraud in the event such fraud was established by "a final and non-appealable adjudication adverse to such Insured in the underlying action" (the Profit/Fraud Exclusion); (2) a requirement that insurer consent be obtained prior to entering into any settlement; (3) a clause requiring the insureds to cooperate with the insurers, including with respect to requests for information; and (4) an allocation provision, providing that in the event of both insured and uninsured matters, the parties would use their best efforts to agree upon allocation, taking into account "the relative legal and financial exposures of the Insureds in connection with the defense and/or settlement of the Claim."[23]

The Coverage Litigation

Several of these excess insurers filed an action in the Delaware Superior Court seeking a declaratory judgment that they had no obligation to fund either the Stockholder Litigation settlement or the San Antonio Action settlement.[24] This coverage litigation led to a number of decisions over the years.

Arch I

On December 23, 2016, the Delaware Superior Court rejected the insurers' contention that the

Chancery Court's detailed post-trial memorandum, holding that Murdock and Carter had committed fraud, constituted a final adjudication that relieved the insurers of any obligation to pay for the Stockholder Litigation settlement.[25] The court found that although the Chancery Court made findings of fraud after trial in the Stockholder Litigation, that court's memorandum opinion was nevertheless not a "final and non-appealable adjudication."[26] The only "final" adjudication in the Stockholder Litigation was the final judgment entered after the court had approved the settlement, and that judgment did not contain any findings of fraud.[27] Nor did the fact that the insureds settled for 100 percent of the amount of their alleged liability, plus interest, render the Profit/Fraud Exclusion applicable in light of the absence of a final judgment finding fraud.[28]

This decision pre-dated the San Antonio Action settlement and thus did not analyze whether the Profit/Fraud Exclusion applied to that matter.

Arch II

On March 1, 2018, the Delaware Superior Court granted in part and denied in part the insurers' motion for summary judgment, ruling on several issues. In relevant part, the court held that Murdock and Carter were collaterally estopped from contesting the findings of fraud at trial in the Stockholder Litigation.[29] It found that the memorandum opinion in the Stockholder Litigation was a "final adjudicat[ion]" (even though it was not a "final and non-appealable adjudication" for purposes of the Profit/Fraud Exclusion), and that, as a result, the court's findings in that case could be used to the extent that they were relevant to issues in the coverage suit.[30] The court also ruled that Delaware law, not California law, applied to the D&O policy.[31] Finally, the court found that the settlements were not uninsurable as a matter of Delaware public policy despite the fact that they were based on fraudulent conduct.[32]

Arch III

On May 1, 2019, the Delaware Superior Court granted the insurers' motion for summary judgment dismissing the insureds' claim that the insurers engaged in bad faith in denying coverage.[33] The court found that the insurers acted based on well-reasoned arguments as to the interpretation of the D&O policy's provisions, even if the court ultimately did not agree with those interpretations.[34] The court also held that it was reasonable, albeit incorrect, for the insurer to have applied California law to the policy (instead of Delaware law) and to have concluded that the claims were uninsurable as a matter of California public policy. Accordingly, the insurer's denial was not in bad faith.[35]

Arch IV

On May 7, 2019, the Delaware Superior Court denied the parties' cross-motions for summary judgment on the issues of consent and cooperation. Although the insureds had notified the insurers of the terms of the Stockholder Litigation and San Antonio Action settlements, the insurers did not provide their consent, and the insureds settled nonetheless.[36] The insureds claimed that the insurers unreasonably withheld their consent. The insurers, though, claimed that they were not given enough time to thoroughly examine the terms, the insureds had failed to provide the information requested by the insurers, and the settlements were unreasonable.[37]

The court held that the consent provision did not give the insurer an unfettered right to veto a reasonable settlement, and that there was an issue of fact as to whether consent was unreasonably withheld and whether the insureds' refusal to provide requested information because of alleged privilege constituted a breach of the insureds' cooperation obligations.[38]

Arch V

On January 17, 2020, the Delaware Superior Court issued a memorandum opinion on the issue of allocation. The insurers argued that some of the loss should be allocated to the uninsured DFC, because DFC was found jointly and severally liable with Murdock and Carter for the damages assessed in the memorandum opinion in the Stockholder Litigation.[39] Second, the insurers argued that

Murdock and Carter, when committing the fraud in connection with the going-private transaction, were acting in both insured and uninsured capacities.[40] Specifically, Murdock was acting in his uninsured capacity as a controlling shareholder of Dole.[41] Moreover, Carter, in his capacity as general counsel, was also uninsured under the policy.[42] Accordingly, the insurers argued that at least a portion of the losses must be allocated to the fraudulent actions taken by the uninsured DFC, and by Murdock and Carter in their uninsured capacities.

The court held that the allocation provision in the policies was inapplicable, because it required the parties to use their best efforts to agree on allocation, which none of the parties did, and therefore had no application when there was neither an effort to agree nor any agreement on allocation.[43] As the allocation provision did not apply, the court needed to decide what allocation formula it should use instead. It decided that the Larger Settlement Rule—which asks whether the settlement was made larger by the actions of the uninsureds—should be used, at least for purposes of the San Antonio Action settlement.[44] The court believed that the Larger Settlement Rule could be applied to the San Antonio Action without further fact-finding because the complaint there expressly asserted joint and several liability of Murdock and Carter. The Stockholder Litigation Complaint, however, did not allege joint and several liability as to all counts, and thus—despite the Chancery Court's memorandum opinion finding all defendants jointly and severally liable—further fact-finding was necessary before the Larger Settlement Rule could be applied to that settlement in a manner that required the insurers to pay, up to their policy limits, for the full amount of the settlement on the basis that the settlement amount was unaffected by any uninsured matters.[45]

According to the court, its "decision to apply the Larger Settlement Rule is to protect the economic expectations of the insured—that is, prevent the deprivation of insurance coverage that was sought and bought. The Larger Settlement Rule applies in those situations where: (1) the settlement resolves, at least in part, insured claims; (2) the parties cannot agree as to the allocation of covered and uncovered claims; and (3) the allocation provision does not provide for a specific allocation method (*e.g., pro rata* or alike)."[46] The court also found that the Larger Settlement Rule was most consistent with the "complete indemnity" promise provided by the policies:

> The Policies cover all Loss that the Insured(s) become legally obligated to pay. Such language implies . . . a complete indemnity for Loss regardless of who else might be at fault for similar actions. The Policies do not limit coverage because of the activities of others that might overlap the claims against the Insureds. Any type of pro rata or relative exposure analysis seems contrary to the language of the Policies.[47]

Despite rejecting the insurers' allocation argument, the court ruled that the insurers nevertheless were not without rights for uninsured portions of the settlements, since they have a right of subrogation under the policies.[48]

Coverage Settlements

All excess insurers except RSUI eventually paid their policy limit or settled with Dole.[49] RSUI's policy was the eighth layer of coverage, with a limit of $10 million that was available only after the underlying $75 million in coverage, plus a $500,000 retention, was exhausted.[50] After exhausting underlying insurance, Dole paid $66 million of the $74 million San Antonio Action settlement itself and sought reimbursement from RSUI up to the limit of RSUI's excess coverage.[51] Although RSUI did not settle, it did forego its right to pursue its defenses of lack of consent and breach of the duty of cooperation, as to which the Superior Court had found a question of fact requiring trial. The withdrawal of these defenses rendered the other coverage decisions of the Superior Court ripe for appeal to the Delaware Supreme Court.

The Delaware Supreme Court Decision

On March 3, 2021, the Delaware Supreme Court ruled in favor of the insureds, holding that: (1) Delaware, not California, law governed the D&O policy; (2) the claims at issue were insurable as a matter of Delaware public policy; (3) the San Antonio Action settlement was not subject to the exclusion in the D&O policy for fraudulent conduct; (4) the insurer could not allocate the San Antonio Action settlement between insured and uninsured matters; and (5) RSUI had not acted in bad faith in denying coverage.

Choice of Law

Because the insurance contract did not include a choice-of-law provision, the Court applied the "most significant relationship" test to determine which state's law governs the contract.[52] The Court looked to the following factors:

- the place of contracting;
- the place of negotiation of the contract;
- the place of performance;
- the location of the subject matter of the contract; and
- the domicile, residence, nationality, place of incorporation and place of business of the parties.[53]

Although Dole was headquartered in California, its directors and officers lived in California, and the insurance policies were negotiated and issued to Dole in California through a California-based broker, the Delaware Supreme Court found that Delaware, as the state of incorporation, has the greatest interest in application of its law given its specific policies affecting D&O insurance, such as laws governing the duties of D&Os and laws empowering Delaware corporations to obtain D&O insurance.[54] Thus, Delaware law applied.

Delaware Public Policy

Next, the Court held that the claims at issue were not uninsurable as a matter of Delaware public policy. The Court emphasized the freedom of sophisticated parties to contract.[55] It based its analysis principally on Section 145(g) of the Delaware General Corporation Law, which authorizes corporations to purchase D&O insurance "against any liability" asserted against directors and officers "whether or not the corporation would have the power to indemnify such person against such liability under this section."[56] The Court reasoned that because Section 145(a) permits corporations to indemnify directors and officers for liabilities arising from good-faith, reasonable conduct, Section 145(g) implies that corporations are able to insure their directors and officers for liabilities arising from bad-faith conduct.[57]

The Profit/Fraud Exclusion

The Court then held that the Profit/Fraud Exclusion did not apply. Again, the exclusion in the D&O policy applied to

> any willful violation of any statute or regulation or any deliberately criminal or fraudulent act, error or omission by the Insured; if established by a final and non-appealable adjudication adverse to such Insured in the underlying action.[58]

With respect to the San Antonio Action settlement, because the exclusion required the finding to be made "in the underlying action," and there was no finding of fraud in the San Antonio Action (even though it was based entirely on the fraud findings made at trial in the Stockholder Litigation), the exclusion had no bearing on coverage for that settlement.[59] Because the policy limit of RSUI—the sole remaining insurer in the litigation—would be exhausted by that settlement, the court did not address whether the Profit/Fraud Exclusion applied to the Stockholder Litigation, and thus did not reach the question whether the court below was correct that the post-trial, pre-judgment memorandum opinion in the Stockholder Litigation finding Murdock and Carter had committed fraud was not a "final and non-appealable adjudication."

Allocation

The Court refused to apply the allocation provision of the policy to either the Stockholder Litigation or the San Antonio Action. The Court agreed with the Superior Court that the Larger Settlement Rule should apply because the allocation provision "does not establish an allocation methodology to be applied in the absence of an agreement between the parties" and "limiting RSUI's responsibility for the Insureds' losses in the manner favored by RSUI ignores other, more substantive, policy language" which, as the Superior Court noted, "implies … a complete indemnity for Loss regardless of who else might be at fault for similar actions."[60] The Delaware Supreme Court further noted that: (1) "RSUI has not argued that the acts of DFC or the actions of Murdock and Carter in their uninsured capacities increased the amount of the Stockholder Litigation settlement"; (2) DFC was found liable in the Stockholder Litigation "to the same extent as" Murdock, and thus "could not have increased the Stockholder Litigation settlement"; (3) RSUI pleaded "no facts that suggest the San Antonio Action settlement represented an admixture of covered and non-covered losses"; and (4) RSUI had provided no explanation of how the "relative exposure" allocation theory "would lead to a reduction in the coverage available to the Insureds."[61]

The Insureds' Bad Faith Claim

Although it rejected RSUI's arguments and interpretation of the policy, the Delaware Supreme Court found that RSUI had not denied the claim in bad faith because there was a "bona fide dispute" as to whether the claim was insurable as a matter of public policy, and RSUI asserted a colorable, if ultimately unsuccessful, argument that the findings at trial in the Stockholder Litigation triggered the Profit/Fraud Exclusion.[62]

Implications

The decisions in the *Dole* litigation have significant implications for both insureds and insurers.

No Delaware Public Policy Restriction

Securities lawsuits and derivative actions often are framed in terms of fraud or intentional misconduct and can be financially devastating for companies and their directors and officers. Large M&A transactions routinely are challenged in the courts, often with allegations of fraud or intentional misconduct. The Delaware Supreme Court's pronouncement in *RSUI* removes all doubt as to whether fraud is insurable under Delaware law. This is significant especially in light of the fact that Delaware law expressly prohibits Delaware corporations from contractually indemnifying their own directors and officers for fraud.[63]

Moreover, although this case involved only fraud and breaches of the duty of loyalty, the Court's analysis was based on a Delaware statute providing that corporations can purchase D&O coverage against "*any* liability." (Emphasis added.) The Delaware Supreme Court's reliance on this language as a statement of the public policy of Delaware likely means that Delaware public policy imposes no restraint at all on the scope of D&O insurance coverage. Accordingly, the liability of D&O insurers will rise or fall based upon the language of their policies.

Indemnification Provided by Limited Liability Corporations and Limited Partnerships

The same public policy analysis would presumably apply to indemnification obligations of other organizational forms, such as Delaware limited liability companies and limited liability partnerships, which are permitted to provide indemnification without restriction for "any and all claims and demands whatsoever" under their respective Delaware statutes.[64]

Insurers Liability for Settlements

In drawing a clear distinction between a final adjudication and a settlement with respect to coverage for fraud, the Delaware courts were faithful to the provisions of the insurance policy, but departed from the holdings of a number of other courts. In *Level 3 Commc'ns, Inc.* v. *Federal Insurance Co.*,[65] for example, in a decision by Judge Posner, the Seventh

Circuit rejected the insured's argument that its settlement of a claim for fraud resulting in unjust enrichment should be covered by insurance because "the line runs between judgments and settlements. As long as the case is settled before entry of judgment, the insured is covered regardless of the nature of the claim against it."[66] According to the Seventh Circuit, "That can't be right."[67] In fact, the Seventh Circuit described a hypothetical remarkably like the situation faced by the Delaware courts in the *Dole* litigation:

> [Level 3's argument would mean] that if Level 3, seeing the handwriting on the wall, had agreed to pay the plaintiffs in the fraud suit all they were asking for (a very large amount—almost $70 million), which they surely would not have done had there been no evidence of fraud (no rational defendant settles a nuisance suit for the full amount demanded in the complaint, unless the amount is trivial), Federal would still be obligated to reimburse Level 3 for that amount. And that would enable Level 3 to retain the profit it had made from a fraud.[68]

Under the Delaware Superior Court decision, even a post-trial finding of fraud, resulting in a settlement prior to judgment for the full amount of the claim, plus interest, would be covered by a D&O policy with the language of the Dole policies. Moreover, again under the Delaware Superior Court decision, an insurer's refusal to consent to such a settlement could be viewed as unreasonable. Although the Delaware Supreme Court did not review these rulings, insureds are apt to rely on them. In addition, it is possible that insureds can argue successfully, even post-judgment, that a motion for reconsideration tolling the time for appeal, or even a settlement during the pendency of an appeal, permits them to settle a fraud claim, even for the full amount of the claim, plus interest, and have that settlement covered by the D&O policy.

The Fraud Exclusion in Settlements of Follow-On Litigation

The Delaware Supreme Court's interpretation of "in the underlying action" was devastating to the insurer's attempt to avoid coverage for the San Antonio Action settlement based on the prior finding of fraud in the Stockholder Litigation. As discussed above, the Court interpreted this language to mean that regardless of whether the Profit/Fraud Exclusion applied to the Stockholder Litigation, it did not exclude coverage for the later San Antonio Action because the "adjudication" of fraud occurred only in the Stockholder Litigation, not the San Antonio Action (even though the San Antonio Action was based entirely on the facts established at trial in the earlier Stockholder Litigation). This is a significant ruling given the prevalence of follow-on litigation in the U.S. court system. Any time a company faces a derivative action based on fraud or breaches of fiduciary duty, it is not uncommon for investors to file a separate securities fraud action. Likewise, investors routinely file securities class actions in the wake of significant corporate criminal proceedings and regulatory enforcement actions (which can often involve findings or admissions of fraud). Thus, the Profit/Fraud Exclusion could operate to exclude coverage for an initial derivative action or criminal case resulting in a final, non-appealable adjudication of fraud, but not a separate, follow-on action based on the exact same conduct that is settled before judgment.

Insureds Ability to Refuse to Provide Privileged Documents

Insurers often insist that the cooperation requirement in their policies requires insureds to provide requested information, even if the information is privileged and the insurers have not agreed to provide coverage. The Delaware Superior Court rejected this proposition, at least as a matter of law, and instead found a question of fact as to whether the insureds' refusal to provide the documents constituted a material breach of the cooperation clause. Although the insurers ended up forgoing this defense, the Superior Court's decision can be used by insureds as another authority in favor of refusing to provide privileged information, particularly when the insurer has not accepted coverage.

Ability of Insureds to Recoup Full Settlement Amount

In the *Dole* litigation, Murdock was a large shareholder of Dole and his actions in taking the company private were undoubtedly at least in large part motivated by his interests as shareholder rather than simply as a director of Dole. Yet none of the settlements involving his and Carter's fraud were required to be allocated in a manner reducing coverage. These decisions, rejecting any such allocation, will enable insureds to contest efforts by D&O insurers to refuse or limit coverage for claims involving actions taken by D&Os in both insured and uninsured capacities.

Possible Insurer Amendments to D&O Policies

In light of the Delaware Supreme Court's decision, insurers may, depending on market conditions, seek to amend their D&O policies in order to avoid the pro-insured rulings in the *Dole* litigation. These efforts could include:

1. Removing or altering the "final and non-appealable adjudication in the underlying action" requirement for application of the fraud exclusion;
2. Changing the "relative exposure" allocation provision to state expressly that the Larger Settlement Rule is inapplicable, to provide greater clarity on how uninsured matters are to be treated, and to render the allocation provision applicable regardless of whether the parties agree on allocation and notwithstanding anything else in the policy; and/or
3. Inserting an express choice-of-law provision in the policy providing for a law other than that of Delaware to apply.

Likelihood of Forum Battles

While the Delaware Supreme Court believed that Delaware, as the place of incorporation, has the greatest interest in application of its law to construction of D&O policies issued to corporations incorporated in Delaware, it is quite possible—and perhaps even likely—that California courts, as California was the principle place of business of Dole and the state where the insurance policies were negotiated and issued, would have had a different view and applied its own law to the issues. Similarly, corporations headquartered in New York with similar types of contacts there could have difficulty persuading a New York court that Delaware public policy, rather than New York's own, should apply because the place of incorporation is in Delaware.

It is, therefore, likely that when there is a coverage dispute concerning claims against insureds that allege fraud or other matters, such as disgorgement, that are uninsurable as a matter of public policy in certain states but not in Delaware, insurers may attempt to bring a coverage action in a state other than Delaware that is apt to apply its own, pro-insurer law concerning insurability. Such an action may well be brought pre-emptively in the insurer's preferred jurisdiction, in the hope that the "first-filed" rule will give its pre-emptive suit priority and withstand a motion to dismiss or stay in favor of a later-filed action by insureds in Delaware.

Notes

1. RSUI Indemnity Co. v. Murdock, No. 154, 2020, 2021 WL 803867 (Del. March 3, 2021).
2. *Id.* at *2.
3. *Id.*
4. *Id.*
5. Sullivan & Cromwell LLP represented the Special Committee in the transaction and underlying litigation. The Chancery Court praised the Special Committee and its counsel for their work in the face of fraud, and S&C obtained the dismissal of all claims against the Special Committee's members before the Stockholder Litigation went to trial.
6. *Id.*
7. *Id.*
8. *Id.*
9. *See generally, In re Dole*, 2015 WL 5052214 (Del. Ch. Aug. 27, 2015).
10. *RSUI Indemnity Co.*, 2021 WL 803867, at *2.

11. *Id.*
12. *Id.*
13. *Id.* at *3.
14. Arch Ins. Co. v. Murdock (Arch IV), 2019 WL 2005750, at *4 (Del. Super. Ct. May 7, 2019).
15. *Id.*
16. *RSUI Indemnity Co.*, 2021 WL 803867, at *3.
17. *Id.*
18. *Id.*
19. *Id.*
20. *Arch IV*, 2019 WL 2005750, at *5.
21. *RSUI Indemnity Co.*, 2021 WL 803867, at *1.
22. *Id.* at *1.
23. *Id.* at *2, *17.
24. *Id.* at *3.
25. Arch Ins. Co. v. Murdock (Arch I), 2016 WL 7414218, *7 (Del. Super. Dec. 21, 2016).
26. *Id.* at *7-8.
27. *Id.*
28. *Id.*
29. Arch Ins. Co. v. Murdock (Arch II), 2018 WL 1129110, at *5-8 (Del. Super. Mar. 1, 2018).
30. *Id.*
31. *Id.* at *8-11.
32. *Id.* at *11.
33. Arch Ins. Co. v. Murdock (Arch III), 2019 WL 1932536, at *6 (Del. Super. Ct. May 1, 2019).
34. *Id.*
35. *Id.*
36. *Id.* at *10-11.
37. *Id.*
38. *Id.*
39. Def. David H. Murdock's Opening Br. in Supp. of his Mot. for Summ. Judgment at 30 & n.8, *Arch Ins. Co.* v. *Murdock*, C.A. No. N16C-01-104 (Del. Super Ct.), filed Sep. 24, 2018; Pltf. Insurers' Br. in Opp. to Defs.' Mots. for Summ. Judgment at 58, Arch Ins. Co. v. Murdock, C.A. No. N16C-01-104 (Del. Super Ct.), filed Oct. 19, 2018.
40. *Id.*
41. *Id.*
42. *Id.*
43. Arch Ins. Co. v. Murdock (Arch V), 2020 WL 1865752, at *6-7 (Del. Super. Ct. Jan. 17, 2020).
44. *Id.* at *7.
45. *Id.*
46. *Id.*
47. *Id.*
48. *Id.* at *8.
49. *RSUI Indemnity Co.*, 2021 WL 803867, at *15.
50. *Id.* at *1.
51. *Id.* at *3.
52. *Id.* at *5.
53. *Id.* at *6. The Court noted that these factors are to be considered in light of overarching choice-of-law principles, including: "(a) the needs of the interstate and international systems, (b) the relevant policies of the forum, (c) the relevant policies of other interested states and the relative interests of those states in the determination of the particular issue, (d) the protection of justified expectations, (e) the basic policies underlying the particular field of law, (f) certainty, predictability and uniformity of result, and (g) ease in the determination and application of the law to be applied." *Id.*
54. *Id.* at *9.
55. *Id.* at *10.
56. Delaware General Corporation Law § 145(g).
57. *RSUI Indemnity Co.*, 2021 WL 803867, at *11.
58. *Id.* at *13.
59. *Id.* at *14.
60. *Id.* at *16.
61. *Id.*
62. *Id.* at *17.
63. Delaware General Corporation Law § 145(a).
64. Delaware Limited Liability Company Act § 18-108; Delaware Revised Uniform Partnership Act § 15-110.
65. Level 3 Commc'ns, Inc. v. Federal Insurance Co., 272 F.3d 908, 911–12 (7th Cir. 2001).
66. *Id.*
67. *Id.*
68. *Id.; see also* Reliance Grp. Holdings, Inc. v. Nat'l Union Fire Ins. Co. of Pittsburgh, Pa., 188 A.D.2d 47, 54, 594 N.Y.S.2d 20, 24 (1993) (criticizing the "untenability" of an insured's construction of its D&O policy that would cover any settlement even for restitution of property wrongfully acquired).

MERGERS AND ACQUISITIONS

A Delaware Court Issues Additional Guidance on Busted Deals

The Delaware Court of Chancery has issued a decision addressing several important topics in the busted deal context that provides lessons for companies and their advisors. It provides guidance as to what constitutes a material adverse change and operating the business in the ordinary course.

By Amy L. Simmerman, Todd Cleary, Douglas K. Schnell, and Ryan J. Greecher

On April 30, 2021, then-Vice Chancellor (now Chancellor) Kathaleen S. McCormick of the Delaware Court of Chancery issued a post-trial decision addressing an array of important topics in the "busted deal" context following a private equity buyer's attempt to terminate its $550 million acquisition of a private cake decorating company. In this decision—*Snow Phipps Group, LLC v. KCAKE Acquisition, Inc.*[1]—the court rejected the buyer's attempt to terminate the deal on the basis of an alleged material adverse change (MAC) in the target's business and the target's alleged failure to operate in the ordinary course. The court also found that the buyer had breached its contractual obligations to use reasonable best efforts to work toward a definitive credit agreement for the acquisition. The court ordered specific performance, requiring the buyer to close the transaction.

Background of the Decision

The case is one of many busted deal litigations filed in the Court of Chancery following the onset of the COVID-19 pandemic—although the conclusions in the case will be relevant for deals in the future. The parties had negotiated the underlying transaction in the first quarter of 2020, signing the deal on March 6 of that year. Although the court decided the dispute based on the language of the transaction documents, the evidence at trial showed that the parties were mindful of the looming pandemic and that the buyer negotiated a 10 percent price cut on the eve of signing given the volatility materializing in the markets. The transaction did not have an express financing contingency but did limit the seller's remedy of specific performance to force a closing to circumstances where debt financing had been obtained or was available. In addition, the buyer was obligated under the acquisition agreement and debt commitment letter to use reasonable best efforts to obtain debt financing or otherwise seek alternative financing.

The target company's business initially "declined precipitously," with its sales falling between 42.4 percent and 63.9 percent year-over-year for the first five weeks post-signing. As 2020 wore on, however, the business began to recover, with 2020 annual revenue ultimately declining only 14 percent and adjusted Earnings Before Interest, Taxes, Depreciation, and Amortization (EBITDA) declining 25 percent, in each case relative to 2019. Like many companies, the target decided in March 2020 to make a partial draw of $15 million on its revolving credit facility out of an abundance of caution, although it never spent the funds and fully repaid them by August 2020. The target also cut various business costs, including labor costs, in the midst of the pandemic, a step it had taken during prior business downturns.

According to the court, the buyer developed "a case of buyer's remorse" in mid-March 2020 when

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it believed that celebrations and related cake orders would decline during the pandemic and as it considered the capital needs of its other portfolio companies and opportunities to pursue distressed debt investing opportunities. The buyer created its own pessimistic and "unsupported" forecasts for the target's business—dismissing the target's forecast that the business would recover fairly quickly based on a process the court described as "painstaking." The buyer sent its pessimistic forecasts to the lenders for the deal along with a demand for revised financing terms that were beyond the scope of the debt commitment letter. When the lenders rejected those demands, the buyer declared that financing was no longer available and made an unsuccessful four-day effort to assess the availability of alternative financing. The evidence at trial, including an email in which the buyer appeared to view the merger agreement as an option, showed that the original lenders believed that the buyer was trying to back out of the deal, even though the lenders remained willing to fund the deal by the agreed-on terms.

Ultimately, in April 2020, the buyer attempted to terminate the deal, citing several bases that would form a familiar pattern during the early stages of the pandemic: the existence of a MAC, a breach of the target's covenant to operate in the ordinary course (in this case, based on drawing on the revolver and cutting costs), and the unavailability of debt financing. The target filed a complaint, seeking specific performance of the acquisition agreement.

The Court's Conclusions

Following trial, the court rejected all of the buyer's grounds for termination. As for an alleged MAC, the court, echoing prior Delaware decisions, noted that a "short-term hiccup" will not suffice and that, absent some specific agreement by the parties, a MAC will only exist where there has been a "durationally significant" change to the business that is "consequential to the company's long-term earnings power over a commercially reasonable period." The court noted that scholars and the court have considered sustained decreases in profits in the "40 percent or higher range" to support the finding of a MAC. Such a sustained drop had not occurred here. In addition, the court found that, because the vast majority of the decline in the target's sales was related to shelter-in-place and closure orders across the country, it fell within the acquisition agreement's carve-out from the definition of a MAC for effects "related to … government orders." The acquisition agreement further provided that such carve-out would be inapplicable if there was a "disproportionate effect" on the target's business compared to "other comparable entities operating in the industry" in which the target company operates, but the court determined no such disproportionate effect had occurred when the target was compared to other businesses in the cake-decorating industry (as opposed to the grocery store industry generally, as the buyer urged). The court rejected a related argument that the target had breached a representation relating to its business with top customers, which also required that any breach rise to the level of a MAC.

The Court determined that the target had not breached its covenant to operate the business 'in a manner consistent with the past custom and practice' of the company.

Separate from the MAC analysis, the court determined that the target had not breached its covenant in the acquisition agreement to operate the business "in a manner consistent with the past custom and practice" of the company, noting that such language required a comparison to the target's prior business practices. Although the target's 2020 draw on its credit facility was larger than prior draws, the company had drawn on the facility five times since 2017. Moreover, the target promptly notified the buyer of the draw request, and the buyer had not given the target the opportunity to cure any alleged breach of the covenant, as the agreement required. Because the target never spent the funds, the court reasoned that the target could clearly cure any breach. As for the target's cost-cutting measures, the court found that the target had a historic practice of cutting costs when the company's sales decreased.

Finally, the court rejected the buyer's position that it did not have to close the deal because debt financing was no longer available. Under the terms of the acquisition agreement, the remedy of specific performance—which would require the buyer to close the deal—was only available if "the full proceeds of the Debt Financing have been funded" to the buyer. The court concluded, however, that the debt financing became unavailable because of the buyer's wrongful demands of the lenders and refusal to move forward under the agreed-on terms. The court applied the "prevention doctrine," which excuses non-occurrence of a condition if a party's breach materially contributed to the non-occurrence. Because the court found that the buyer breached its obligation to use reasonable best efforts to arrange and obtain debt financing, it was therefore precluded from refusing to perform its obligations under the acquisition agreement due to the non-occurrence of financing. The court rejected the buyer's argument that the doctrine required bad faith conduct, finding that the doctrine only required a showing of wrongful conduct that materially contributed to the failed condition.

The court found that the target demonstrated it was entitled to an order of specific performance requiring the buyer to close the acquisition and use reasonable best efforts to obtain alternative financing. The court also requested further briefing on whether the acquisition agreement was written to allow the target to seek prejudgment interest on the deal price from the outside closing date of May 4, 2020, in addition to a specific performance remedy requiring the buyer to close.

Takeaways

As with many other recent deal litigations leading up to and during the pandemic, the case offers important lessons to companies and advisors in the deal context. First, Delaware courts will not easily find a MAC, and the bar remains high for buyers to back out of a deal on the basis of one. Second, carve-outs to MAC clauses (including "carve-outs to carve-outs" related to disproportionate effects on a target) should be considered carefully and appropriately tailored. Third, deal litigation during the pandemic, in which businesses have had to adapt to changed circumstances, has highlighted that parties should pay careful attention not only to MAC clauses, but also to covenants that require a target to operate in a particular way in the period between signing and closing. For example, many acquisition agreements now provide that a target need only use reasonable best efforts (or some other efforts standard) to operate in the ordinary course or provide an explicit carve-out to the ordinary course requirement for actions taken in response to COVID-19 measures (such as shelter-in-place or shut-down orders).

Delaware courts will not easily find a MAC.

This new decision is an interesting counterpart to the Court of Chancery's *AB Stable*[2] decision, which determined that another pandemic-caused busted deal did not involve a MAC but did involve a breach by the target of the ordinary course covenant. Finally, this decision provides important insights into remedies provisions in acquisition agreements, and whether and when private equity buyers, which often rely on financing, may be permitted to back out of a deal based on the availability and terms of financing.

Notes

1. *Snow Phipps Group, LLC v. KCAKE Acquisition, Inc,* C.A. No. 2020-0282-KSJM (Del. Ch. Apr. 30, 2021).
2. AB Stable VIII LLC v. MAPS Hotels and Resorts One LLC, C.A. No. 2020-0310-JTL (Del. Ch. Nov. 30, 2020).

IN THE COURTS

First Department Affirms Denial of Motion to Dismiss in Securities Act Class Action

By Roger A. Cooper, Jared Gerber, and Guiherme Duraes

On April 29, 2021, the First Department issued a short decision in *Chester County Employees Retirement Fund v. Alnylam Pharmaceuticals, Inc.*, affirming in substantial part the trial court's denial of a motion to dismiss in a class action asserting claims under the federal Securities Act of 1933 (Securities Act). The decision is notable because it departs from four earlier First Department decisions dismissing Securities Act class actions, and is the first time that a New York state appellate court has permitted a Securities Act class action to proceed past a motion to dismiss. The *Alnylam* decision thus serves as a reminder that state courts remain a viable forum for Securities Act class actions, including in circumstances where federal courts have granted motions to dismiss in parallel class actions.

Background of Securities Act Class Actions in New York State Courts

In March 2018, the US Supreme Court held in *Cyan, Incorporated v. Beaver County Employees Retirement Fund* that state courts possess jurisdiction to adjudicate Securities Act class actions, notwithstanding the provisions of Securities Litigation Uniform Standards Act (SLUSA) that stripped state courts of jurisdiction over certain class actions asserting securities law claims.[1] The Supreme Court did so despite hearing concerns from a large number of *amici* that state courts often have more liberal pleading standards than federal courts and are therefore less likely to dismiss meritless claims.

Following that decision, New York state courts (and others) experienced a notable increase in the filing of Securities Act class actions.[2] However, notwithstanding the circumstances described by *amici* in *Cyan*, the initial rulings from appellate courts in New York dismissed a number of those actions. In particular, in a series of decisions issued over the course of four months, the First Department affirmed the dismissal of two Securities Act class actions and reversed the denials of motions to dismiss in two others.

In the first of these decisions, issued in December 2020, the First Department reversed a lower court's denial of a motion to dismiss certain Securities Act claims against an e-commerce company, holding that "disclosure [of the omission in question] would not have given a more accurate picture of the status of the business."[3] Subsequently, in February 2021, the First Department affirmed a lower court's dismissal of a Securities Act suit on statute of limitations grounds, rejecting the plaintiffs' argument that they could only have brought claims after the defendant's stock price declined precipitously.[4] Later in the same month, the First Department upheld the dismissal of another Securities Act class action, on the grounds that the alleged misstatements were non-actionable puffery or opinions and that the offering documents sufficiently warned of the relevant risk.[5] Finally, in March 2021, the First Department reversed a lower court's decision and ordered the dismissal of a Securities Act complaint, reasoning that the plaintiff had failed to plead that the challenged statements of opinion were actionable.[6]

In sum, until the decision in *Alnylam*, all appeals of motions to dismiss Securities Act class actions in

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New York state court had resulted in dismissal of the complaints.

The *Alnylam* Decision

The *Alnylam* case originally was filed in New York state court in September 2019, following the filing of a related class action in federal court asserting claims under the Securities Exchange Act of 1934 (Exchange Act).

The plaintiff in the state court action, a retirement fund that allegedly purchased stock in the November 2017 initial public offering by pharmaceutical company Alnylam Pharmaceuticals, Inc. (Alnylam), alleged that Alnylam, and certain of its officers, directors, and underwriters, violated the Securities Act by making material misstatements and omissions about patisiran, a drug that Alnylam was developing.[7] In particular, the complaint alleged that Alnylam's registration statement misrepresented that clinical studies had demonstrated patisiran's efficacy for treating cardiomyopathy, a heart muscle disease that can lead to heart failure.[8] The plaintiff alleged these statements were false because, in August 2018, the Food and Drug Administration (FDA) denied Alnylam's application to use partisiran for cardiomyopathy, and subsequently issued a report revealing that Alnylam's clinical studies had not supported the use of the drug for the condition.[9]

On November 7, 2019, the trial court denied the defendants' motion to dismiss that complaint.[10] The trial court rejected a statute of limitations argument made by the defendants, holding that there was no documentary evidence as to when the relevant report cited by defendants had become available.[11] With respect to the complaint's claim under Section 11 of the Securities Act, the court reasoned that the plaintiff had pled a violation with enough particularity, that the alleged misstatements constituted statements of fact and not opinions, and that plaintiff did not need to make allegations about scienter.[12] With respect to the complaint's claim under Section 12(a)(2), the trial court held that officers or directors of an issuer who sign the issuer's registration statement often have been deemed to have solicited the purchase of the offered stock and can therefore be considered "statutory sellers," at least on a motion to dismiss.[13] Lastly, with respect to the complaint's claim under Section 15, the court declined to impose a requirement of pleading "culpable conduct" and held that plaintiffs may assert securities law violations against a single defendant as both primary violator and controlling person.[14]

The defendants appealed, and during the pendency of that appeal the federal court considering the Exchange Act class action granted the defendants' motion to dismiss, holding that the complaint failed to plead material misstatements, that certain challenged statements were protected by the Private Securities Litigation Reform Act (PSLRA) safe harbor for forward-looking statements, and that the complaint failed to raise a strong inference of scienter.[15] On April 29, 2021, however, the First Department issued a short decision affirming the trial court's decision in the Securities Act class action.

In its ruling, the First Department stated that the defendants "failed to utterly refute plaintiff's factual allegations and conclusively establish a defense to the asserted claims as a matter of law."[16] The court further held that,

> at this stage of the litigation, there is no basis to find, as a matter of law, that plaintiff has failed to assert valid claims by alleging that in the circumstances here, the registration statements, prospectus or oral communication included either untrue statements of fact concerning the [clinical] Study or statements of opinion about that study that were misleading to a reasonable investor by omission of material facts concerning the lack of cardiac efficacy data, as later confirmed by the FDA.[17]

The court therefore concluded that "defendants fail to establish that plaintiff's claims . . . are premised on nonactionable statements of opinion."[18] On the other hand, the First Department reversed the decision below to the extent it declined to dismiss the Section 12(a)(2) claims against the individual defendants, holding that the mere allegations that those defendants "reviewed and signed the registration statements" were "insufficient to establish that they are statutory sellers."[19]

Conclusion

Although the First Department's decision in *Alnylam* was relatively brief, it demonstrates that New York state courts are willing to entertain Securities Act class actions when faced with adequately pleaded complaints, notwithstanding the First Department's string of prior decisions dismissing such actions. Moreover, the First Department's decision also demonstrates that New York courts are willing to permit actions to proceed even where a complaint concerning similar underlying facts is dismissed in federal court (albeit, in this instance, one asserting Exchange Act claims subject to heightened pleading standards, requiring scienter, and subject to the PSLRA safe harbor for forward-looking statements). It remains to be seen, however, whether the *Alnylam* decision will lead to a further increase in Securities Act class actions filed in New York state court, or if the First Department's earlier decisions will deter such filings.

Another important question is how New York courts ultimately will decide to treat federal forum provisions, which issuers of securities are increasingly adopting, particularly in connection with IPOs.[20] No New York court has ruled on the enforceability of these provisions yet, but with decisions such as *Alnylam*, that may soon change; the rulings on enforceability will affect the number and types of Securities Act claims that are brought in state court, and whether *Alnylam* is the start of a new trend of state court cases proceeding past motions to dismiss.

Notes

1. Cyan, Inc. v. Beaver Cty. Emps. Ret. Fund, 138 S. Ct. 1061, 1078 (2018).
2. Cornerstone Research, Securities Class Action Filings: 2020 Year in Review, at 19, 23.
3. Lyu v. Ruhnn Holdings Ltd., 189 A.D.3d 441, 442 (1st Dep't 2020), leave to appeal denied sub nom. Jianming Lyu v. Ruhnn Holdings Ltd., No. 2021-52, 2021 WL 1741338 (N.Y. May 4, 2021).
4. In re Dentsply Sirona, Inc. S'holders Litig., 191 A.D.3d 404, 404-05 (1st Dep't 2021).
5. In re Sundial Growers, Inc. Sec. Litig., 191 A.D.3d 543, 544 (1st Dep't 2021).
6. Labourers' Pension Fund of Cent. & E. Canada v. CVS Health Corp., 192 A.D.3d 424 (1st Dep't 2021).
7. Chester Cnty. Emps. Ret. Fund v. Alnylam Pharms., Inc., No. 655272/2019, slip op. at 2 (N.Y. Sup. Ct. Oct. 30, 2020).
8. Amended Complaint for Violations of the Federal Securities Laws at ¶ 80, Chester Cnty. Emps. Ret. Fund v. Alnylam Pharms., Inc., No. 655272/2019 (N.Y. Sup. Ct. Nov. 7, 2019).
9. *See Alnylam*, No. 655272/2019, slip op. at 4.
10. *See Alnylam*, No. 655272/2019, slip op. at 17.
11. *Id.* at 12-13.
12. *Id.* at 13-15.
13. *Id.*
14. *Id.* at 16.
15. Leavitt v. Alnylam Pharms., Inc., 451 F. Supp. 3d 176 (D. Mass. 2020).
16. Chester Cnty. Emps. Ret. Fund v. Alnylam Pharms., Inc., Case No. 2020-04534, slip op. at 1 (N.Y. 1st Dep't Apr. 29, 2021).
17. *Id.* at 2.
18. *Id.*
19. *Id.*
20. In an attempt to avoid multiple, parallel Securities Act filings, some companies conducting IPOs or follow-on offerings have started including exclusive federal forum provisions in their certificate of incorporation. Last year, the Delaware Supreme Court held that these provisions are enforceable under Delaware law. *See* Salzberg v. Sciabacucchi, 227 A.3d 102 (Del. 2020). And California state courts have upheld these types of federal forum provisions on two occasions. *See* Wong v. Restoration Robotics, Inc., No. 18CIV02609 (Cal. Super. Sept. 1, 2020); In re Uber Techs. Sec. Litig., No. CGC-19-579544 (Cal. Super. Nov. 16, 2020).

CLIENT MEMOS

A summary of recent memoranda that law firms have provided to their clients and other interested persons concerning legal developments. Firms are invited to submit their memoranda to the editor. Persons wishing to obtain copies of the listed memoranda should contact the firms directly.

Akin, Gump, Strauss, Hauer & Feld LLP
Washington, DC (202-887-4000)

Recent SPAC Shareholder Suits In New York State Courts (April 8, 2021)

A discussion of shareholder lawsuits filed against special purpose acquisition companies (SPACs), target companies and their directors in New York state courts between September 2020 and March 2021.

Arnold & Porter Kaye Scholer LLP
Washington, DC (202-942-5000)

SPAC Transactions: Enforcement and Litigation Risks (April 7, 2021)

A discussion of the scrutiny of SPACs by market regulators, including the Securities and Exchange Commission (SEC) and the Financial Industry Regulatory Authority (FINRA) as well as private plaintiffs.

SEC Staff Updates Guidance for Shareholder Proposals in Light of COVID-19 Concerns (April 12, 2021)

A discussion of the updating of guidance by the Staff of the SEC to extend shareholder proposal presentation procedures through the 2021 proxy season.

Baker Hostetler LLP
Chicago, IL (312-416-6200)

The Future of SEC Enforcement under the Biden Administration (April 16, 2021)

A discussion of an expected change in the SEC's current emphasis on capital formation to focus more on investor protection and such areas as: security-based swaps; Dodd-Frank required rules; and inspections, examinations, and enforcement.

Cadwalader, Wickersham & Taft LLP
New York, NY (212-504-6000)

Southern District of New York Dismisses Putative Action Alleging Sale of Unregistered Cryptocurrency (April 23, 2021)

A discussion of a decision of the US District Court for the Southern District of New York, *In re Bibox Group Holdings Ltd. Securities Litigation*, dismissing a putative class action alleging registration violations of securities laws against a cryptocurrency issuer and an exchange for lack of standing.

Cahill Gordon & Reindel LLP
New York, NY (212-701-3000)

SEC Amendments to Exempt Offering Rules Become Effective (April 15, 2021)

A discussion of SEC final rules to amend the "patchwork" framework for exempt securities offerings.

SEC Charges AT&T and Individual Executives with Violations of Regulation FD (April 30, 2021)

A discussion of a SEC enforcement action against AT&T, Inc. and three executives in its Investor Relations Department for violating Regulation Fair Disclosure under the Securities Exchange Act of 1934 (Exchange Act).

Chapman and Cutler LLP
Chicago, IL. (312-845-3000)

SEC Issues Risk Alert on ESG Investing (April 14, 2021)

A discussion of a Risk Alert issued by the SEC Division of Examinations highlighting observations from recent examinations of investment advisers, registered investment companies and private funds offering products and services that incorporate ESG factors.

Davis Polk & Wardwell LLP
New York, NY (212-450-4000)

Ninth Circuit Affirms Dismissal of Securities Class Action (April 19, 2021)

A discussion of a Ninth Circuit Court of Appeals decision, *Panthera Investment Fund L.P. v. H.C. Wainwright & Co., LLC*, holding that plaintiffs failed to plead a "strong inference" of scienter under the Private Securities Litigation Reform Act (PSLRA), confirming that plaintiffs face a difficult task in alleging scienter when they cannot adequately plead a plausible motive.

Jenner & Block LLP
Chicago, IL (312-222-9350)

SEC Issues Alert Encouraging Broker-Dealers to Strengthen Anti-Money Laundering Compliance (April 7, 2021)

A discussion of a Risk Alert issued by the SEC Division of Examinations reminding broker-dealers of their anti-money laundering obligations.

Jones Day LLP
Cleveland, OH (216-586-3939)

SEC Awards More Than $500,000 to Individual Whistleblower under "Safe Harbor" for Prior Internal Reporting (April 2021)

A discussion of SEC awards to whistleblowers so far in 2021, which surpasses total awards in fiscal 2020.

Latham & Watkins LLP
Los Angeles, CA (213-485-1234)

FINRA Proposes Amendments to Margin Requirements Rules (April 13, 2021)

A discussion of FINRA's proposed amendments to its margin requirement rules that would significantly alter the landscape for extended settlement of securities offerings by expressly limiting the public offering exception for "when issued" securities to equity IPOs.

Mayer Brown LLP
Chicago, IL (312-782-0600)

SEC Reopens Universal Proxy Comment Period (April 20, 2021)

A discussion of the SEC's issuance of a release reopening the comment period on its proposal for a mandatory universal proxy to be used for all contested director elections.

Mintz, Levin, Cohn, Ferris, Glovsky & Popeo P.C.
Boston, MA (617-542-6000)

Director Fiduciary Duties May Extend Post-Closing in Multi-Stage Transactions (April 16, 2021)

A discussion of a decision by the US District Court for the Southern District of New York, *In re Nine West LBO Securities Litigation*, highlighting directors' fiduciary duty to evaluate all aspects of multi-stage transactions, including those portions to be effectuated post-closing by successor directors.

Morris, Nichols, Arsht & Tunnell LLP
Wilmington, DE (877-772-6628)

Delaware Corporation Law Section Approves Amendments to Delaware's Alternative Entity Acts (April 2021)

A discussion of proposed amendments to the Delaware Revised Uniform Partnership Act, the

Delaware Revised Uniform Partnership Act and the Delaware Limited Liability Company Act approved by the Corporation Law Section of the Delaware State Bar Association.

Nixon Peabody LLP
Rochester, NY (585-263-1000)

C-Suite to J-Cell (April 21, 2021)

A discussion of a Department of Justice Foreign Corrupt Practices Act action and settlement that is a teachable moment for companies and their compliance departments as it sends a clear message of individual accountability for corporate wrongdoing and that an extensive bribery scheme can occur foe decades without detection.

Paul, Weiss, Rifkind, Wharton & Garrison LLP
New York, NY (212-373-3000)

SEC Approves Amendments to NYSE Shareholder Requirements (April 9, 2021)

A discussion of SEC approval of the New York Stock Exchange's proposed amendments to its shareholder approval requirements applicable to issuances to related parties and private placements in excess of 20 percent of a listed company's common stock.

Perkins Coie LLP
Seattle, WA (206-359-8000)

A Checklist for Companies Considering Whether to Speak on Political Issues (April 12, 2021)

A discussion of a framework for companies and their executives to follow when deciding whether and how to engage in political issues.

Reed Smith LLP
New York, NY (212-521-5400)

Delaware Court of Chancery Partially Grants Books-and-Records Demand Based on Short-Seller's Report (April 2021)

A discussion of a Delaware Court of Chancery decision, *Jacob v. Bloom Energy Corp.*, granting a stockholder request to inspect limited documents for the purpose of investigating financial misrepresentations. The inspection demand drew heavily from a research report published by a short-seller.

Schulte Roth & Zabel LLP
New York, NY (212-756-2000)

SPAC Litigation Alert: SEC Cautions SPAC Participants That Claims of Reduced Liability Exposure Are Overstated (April 13, 2021)

A discussion of a statement by SEC Division of Corporation Finance Director Coates explaining to retail investors the basic mechanics and key risks of SPACs.

Seward & Kissel LLP
New York, NY (212-574-1200)

SEC Division of Examinations Announced 2021 Examination Priorities (April 12, 2021)

A discussion of the announcement by the SEC Division of Examinations regarding its examination priorities for fiscal year 2021.

Sullivan & Cromwell LLP
New York, NY (212-588-4000)

Delaware Chancery Court Strikes Down "Unprecedented" Poison Pill (April 8, 2021)

A discussion of a Delaware Court of Chancery decision, *The Williams Companies Stockholder Litigation,* enjoining the operation of a stockholder rights plan.

Troutman Pepper Hamilton Sanders LLP Atlanta, GA (404-885-3000)

Ninth Circuit Clarifies the Role of Materiality in Triggering SLUSA's Class Action Bar (April 16, 2021)

A discussion of a Ninth Circuit decision, *Anderson v. Edward D. Jones & Col, L.P.*, holding that the Securities Litigation Uniform Standards Act did not bar a state law class action for alleged breach of fiduciary duties brought by investors against a financial advisory firm.

Winston & Strawn LLP Chicago, IL (312-558-5600)

SEC Division of Examinations Continues to Focus on Digital-Asset Securities (April 15, 2021)

A discussion of a Risk Alert issued by the SEC Division of Examination highlighting its continued focus on digital assets that are securities.

INSIDE THE SEC

Dialogue with the Acting Director of the Division of Corporation Finance

At the Spring meeting of the American Bar Association Business Law Section held virtually April 19-23, 2021, the Federal Regulation of Securities Committee held its dialogue with the director of the SEC Division of Corporation Finance. The Chair of the Section, Robert Buckholz, led the questioning of Acting Director John Coates and covered a broad range of topics. Mr. Coates led with the traditional disclaimer that the views he expressed were his own and not those of the SEC Commissioners or the Staff.

Current Priorities for Public Companies

Mr. Coates began with general observations about the Division's current priorities, which include ESG (environmental, social and governance matters), SPACs (special purpose acquisition companies,) and proxy plumbing. He noted that the new Chair, Gary Gensler, had just started and he had not yet met with him to discuss priorities. There, however, will be a Spring Regulatory Flexibility Agenda coming out in the near future which will reflect the Chairman's priorities. (Editor's note: This Agenda was released on May 11, 2021, Release No. 33-10942.)

ESG

Much of the focus related to ESG has been on climate change, Mr. Coates noted, which is evolving since the guidance the Commission issued in 2010. Acting SEC Chair Lee recently asked the Staff to review this guidance and related rules and opened a comment file for public input. In a general statement about public comments, Mr. Coates indicated that comments that recognize the three-part mission of the SEC—protecting investors, facilitating capital formation and maintaining fair, orderly, and efficient markets—were most helpful. He also said that the United States was playing catch up with the rest of the world when it came to climate change disclosure, noting that on the day he spoke the European Union proposed making large companies, both publicly listed and private companies, report standardized information about their impact on the environment and social metrics, such as how they treat their employees. In response to a question about the Division's review of current company climate change disclosure, Mr. Coates said it was designed to make sure they had input on how companies were implementing the existing guidance and how the disclosure was being used in the investment process.

Mr. Coates then addressed conceptual issues related to ESG. He noted that the SEC was being both adaptive (looking at existing regulations) and innovative (looking at new components of ESG) approaches. In terms of adaptive, he cited the asbestos experience, noting that initially asbestos exposure was not looked upon as of financial concern, then risks appeared, then more companies considered the information material and finally a number of companies went bankrupt due to asbestos exposure. In terms of innovation, he noted that companies are feeling the need to respond to investor demands and some on the company-side are calling for consistency. In that respect, Mr. Coates noted that perhaps a standard setter other than the SEC might play a role.

Mr. Coates then turned to the important matter of materiality. While there have been discussions about the difference between securities law materiality and other definitions of materiality, he thought that it really was an academic argument and that over time there would not be practical differences. He said that companies already are responding to what investors are asking for, but many are suffering from survey fatigue, and would like commonality in knowing how to respond. Similarly, investors would like consistency, and they and companies are concerned about reliability.

In terms of ESG concepts other than climate change, such as diversity and political contributions, they are evaluating a range of issues, noting that there already are some requirements related to diversity. When asked about qualitative materiality, such as with respect to related party disclosure requirements, Mr. Coates noted that there are circumstances in which political contributions might be material, as they could lead to corruption, or diversity, which could lead to questions of board effectiveness. In addressing the new human capital disclosure requirements, Mr. Coates noted that some companies are doing an admirable job, while other companies do not seem to recognize that the rules have changed.

SPACs

The current wave of SPACs filings and related SEC statements and guidance dominated much of the discussion at the meeting among securities lawyers and was discussed at length by Mr. Coates. He initially addressed his recent statement about the risk and liability rules related to SPACs and initial public offerings (IPOs), which was based on research he had done and discussion with practitioners on the deal and litigation side.[1] He noted that the Private Securities Litigation Reform Act (PSLRA) safe harbor is only available for private plaintiffs not the SEC and some components of SPACs, such as conflicts of interest, may raise liability issues. In that regard, Mr. Coates said that how best to disclose information about conflicts was challenging and they were reviewing such disclosures carefully.[2] He also noted that the exclusion for IPOs in the PSLRA is not clear. Finally, he advised that practitioners should not write disclosure for SPAC transactions any different than IPOs since the economics are the same and liability should be as well.

Mr. Coates then turned to the most recent SPAC guidance the SEC had issued concerning the accounting treatment of warrants, which indicated that liability versus equity treatment would be appropriate in some cases.[3] While one company had requested guidance, the Staff wanted the market to be aware of this as other companies were seeking to go effective. He did note that companies needed to think through the materiality question with their accountants in deciding how to move forward.

When asked about other SPAC regulatory matters, Mr. Coates indicated that in connection with their review of SPAC filings, they were looking at projections and related valuations. Among the matters they are addressing are whether the elements going into the projections are internally consistent and whether the forecast period is reasonable. On a more philosophical note, he questioned whether there should be a difference in the disclosures provided in SPACs, IPOs and direct listings.

China-Based Companies

Mr. Buckholz noted the Division guidance issued last November[4] and recent legislation—the Holding Foreign Companies Accountability Act, which requires the SEC to prohibit the securities of foreign companies being listed or traded on US securities markets if the company retains a foreign accounting firm that cannot be inspected by the Public Company Accounting Oversight Board (PCAOB) for three consecutive years, beginning in 2021, because the accounting firm is located in a foreign jurisdiction that does not permit PCAOB inspections. Mr. Coates indicated that the Commission had adopted interim final rules,[5] but that the PCAOB had not yet taken action. Thus, the law's implementation is not likely for a while—probably annual reports for 2022 filed in 2023. In the meantime, the Division's November 2021 guidance remains in place.

COVID-19 Disclosures

Mr. Coates indicated that companies' disclosure with respect to COVID-19 continue to evolve as the pandemic evolves and its impact on the individual company does as well. In particular, he mentioned supply chain disruptions, especially from countries that are still way behind the US in terms of recovery. He noted that disclosures in this area are a moving target for many companies and their disclosure teams.

LIBOR Transition

Mr. Coates testified on April 18, 2021, about disclosure issues relating to the transition away from LIBOR.[6] At this hearing, he indicated that the discontinuation of LIBOR will have an impact and create indirect risks for some companies, particularly for those that are not working on the transition as it is not easy to address overnight. The most significant challenge is for distressed companies that are subject to the Trust Indenture Act. Other issues to consider in addition to risks are disclosure, information technology, internal controls and disclosure policies and procedures.

Shareholder Proposals

Mr. Buchkolz noted that in September 2019, the Staff had shifted its approach to dealing with shareholder proposals, declining to issue as many written responses and providing transparency through a page on the Division's website. Mr. Coates said he had arrived mid-stream in shareholder proposal season, but was impressed with the Staff's thoughtfulness and seriousness in addressing shareholder proposals. He said the shareholder proposal page had been updated and people seemed happy with it.

In response to a question about the adoption of amendments changing the shareholder proposal thresholds,[7] Mr. Coates noted that the amendments did not apply for this year and, perhaps as a result, there were more proposals this year. More proposals also were withdrawn and more were excluded on procedural grounds. Otherwise, it was business as usual this year.

Proxy Matters

The Commission recently reopened the comment period for its universal proxy proposal,[8] and Mr. Coates noted that, since the 2016 proposal, more companies have gotten familiar with the use of a universal proxy card. He viewed this as positive as a premise of the proposal is to replicate what happens at a shareholder meeting.

Mr. Coates next turned to proxy plumbing, which he indicated was a personal issue he wanted to address. The fact that votes cannot be counted reliably is not good, and he views it as a matter of willpower. He wants to start with vote confirmation which is good for companies and investors. While he recognizes the complexity of the voting system, he thought it should only take pushing by issuers in combination with cooperation from the intermediaries, some of whom are subject to SEC oversight (*e.g.*, transfer agents), to remedy. He invited input on anything the SEC could do to facilitate.

Virtual Shareholder Meetings

Mr. Coates began by noting the silver lining of virtual meetings in terms of opening people's eyes to what can happen online. He indicated that the Staff recently had reiterated the guidance it issued last year with respect to virtual annual meetings.[9] He emphasized the need for clear disclosure and similar support as for in person meetings. In this regard, companies should not overreach as shareholder meetings play an important role.

Other Matters

Mr. Buckholz inquired as to the Archegos Capital Management situation, and, while it does not raise Corporation Finance issues, for the most part, he noted that there are no 13(d) requirements for total return swaps. Mr. Coates noted that the definition of beneficial ownership does not currently include swaps. However, the Dodd-Frank Act does give the SEC the authority to change that, but it does require them to make certain findings. He expressed support for closing some of the generic loopholes in the 13D/G regime, but is not sure the Division had the bandwidth to address it. He once again noted that he had not yet discussed priorities with the new Chair.

Mr. Buckholz than asked about the pending proposal to amend Rule 144 and Form 144 to revise the holding period for securities acquired upon the conversion or exchange of certain market-adjustable securities of issuers that do not have securities listed on a national securities exchange.[10] Mr. Coates indicated that the Division would present a rule recommendation to the Commission but they currently still are reviewing the comment letters. In terms of moving Form 144s to electronic filing, Mr. Coates said that the comments supported that, and that it also was possible that some forms could be eliminated.

Finally, Mr. Buckholz referred to the amendment of the definition of accredited investor that had been adopted by the Commission last August[11] related to the categories of qualifying natural persons and entities and certain other modifications. He inquired whether more would be done. Mr. Coates said they needed to see how the amendments were working. He noted that the net worth thresholds in the definition had not been changed, and suggested that perhaps the amount of investment limitations in Regulation A might be a good model as it would present an alternative to the current all or nothing approach. Once again, he noted that he had not yet talked to the Chair about priorities.

Notes

1. April 8, 2021 SPACs, IPOs and Liability Risk under the Securities Laws John Coates, Acting Director, Division of Corporation Finance.
2. CF Disclosure Guidance: Topic 11, Special Purpose Acquisition Companies (December 22, 2020).
3. Staff Statement on Accounting and Reporting Considerations for Warrants Issued by Special Purpose Acquisition Companies (SPACs) John Coates, Acting Director, Division of Corporation Finance Paul Munter, Acting Chief Accountant (April 12, 2021); Staff Statement on Select Issues Pertaining to Special Purpose Acquisition Companies, Division of Corporation Finance (March 31, 2021).
4. CF Disclosure Guidance: Topic 10, Disclosure Considerations for China-Based Issuers (November 23, 2020).
5. Release No. 34-91364 (March 18, 2021).
6. Testimony of John Coates, Acting Director, SEC Division of Corporation Finance, before the House of Representatives Committee on Financial Services, Subcommittee on Investor Protection, Entrepreneurship and Capital Markets (April 18, 2021).
7. SEC Release No. 34-89964 (September 23, 2020).
8. SEC Release No. 34-91603 (April 16, 2021).
9. Staff Guidance for Conducting Shareholder Meetings in Light of COVID-19 Concerns, updated as of April 7, 2020, and April 9, 2021).
10. Release No. 33-10911 (December 22, 2020).
11. Release No. 33-10824 (August 26, 2020).

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