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Insights Into Corporate Governance, M&A and Securities Law

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Private Equity Controller-Led Sale Transactions Found Not to Involve Liquidity-Driven Conflict of Interest


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On January 7, 2025, the Delaware Court of Chancery issued a post-trial opinion in *Manti Holdings, LLC v. Carlyle Group. Inc.*, finding that the sale of a portfolio company by a controlling stockholder was not the result of a liquidity-driven conflict, in part because the controlling stockholder "did not extract a non-ratable benefit from the sale." The opinion, written by Vice Chancellor Glasscock, features three key points:

- Plaintiffs have a high bar to successfully demonstrate a liquidity-driven conflict;
- A well-documented, robust sale process provides a strong defense against charges of conflict; and
- A negative ruling at the pleading stage is not outcome-determinative for defendants.

This case arose from the 2017 sale of Authentix Acquisition Company, Inc. ("**Authentix**") to Blue Water Energy LLP. At the time of the sale, The Carlyle Group Inc. and its affiliates (collectively, "**Carlyle**") owned 70% of Authentix' preferred stock and 52% of the common stock. The plaintiff minority stockholders asserted that Carlyle was a controller of Authentix and that the sale was a conflicted transaction. Plaintiffs' argued that Carlyle was conflicted because of its business model and certain contractual provisions in its fund documents – which prevented the fund from raising additional capital after 10 years and included a "clawback provision" that required the fund to return to limited partners the 7% preferred return on Carlyle's interest in Authentix for so long as it retained the investment. According to the plaintiffs, Carlyle was motivated by its fund lifecycle and desire to increase its carried interest by cutting off the 7% clawback, which drove Carlyle to sell Authentix prematurely via a sales process that disadvantaged minority stockholders. Plaintiffs asked the court to apply the entire fairness standard because Carlyle's financial interests created a liquidity-driven conflict in respect of the sale.

Liquidity-Driven Conflicts Will be Found Only in Limited Circumstances

Plaintiff stockholders argued that Carlyle was a controller of Authentix and that because it had a liquidity-driven conflict (because of the 10-year fund life and clawback provision) it caused Authentix to be sold at a discounted price "unfair to the stockholders, but from which Carlyle extracted a unique benefit." The Court held that, while the 10-year investment and clawback provisions may have incentivized the sale and caused Carlyle to want the sale to occur in 2017, there was no crisis-driven "fire sale" nor did Carlyle receive any benefit not shared pro rata by all stockholders. The Court noted that the 10-year lifecycle prevented Carlyle from making further investments, including into Authentix, but did not expressly mandate a sale and that this, together with the desire to eliminate the 7% clawback, may have incentivized Carlyle to sell, but did not otherwise result in a conflict.

Looking to prior Delaware precedent (*In re Synthes, Inc., S'holder Litig.*), the Court explained:

[T]here are very narrow circumstances in which a controlling stockholder's immediate need for liquidity could constitute a disabling conflict of interest . . . .

Those circumstances would have to involve a crisis, fire sale where the controller, in order to satisfy an exigent need (such as a margin call or default in a larger investment) agreed to a sale of the corporation without any effort to make logical buyers aware of the chance to sell, give them a chance to do due diligence, and to raise the financing necessary to make a bid that would reflect the genuine fair market value of the corporation.

Here, rather than being driven by an exigent need, the Court found that the timing of the sale was motivated by the "volatility of Authentix' business" and that Carlyle's evaluation of the question, "To sell now or wait for a better opportunity later?" fell squarely within the realm of business judgment.

The Importance of a Robust Sale Process

Although the Court stated its decision was based on the fact that neither the 10-year term of the fund nor the clawback provision mandated a sale and that a preference by the controlling stockholder, without more, does not create a conflict necessitating entire fairness review, Vice Chancellor Glasscock's opinion itemizes (twice) the key steps Authentix' board took in their marketing and sales process. The opinion looked favorably on the auction process: contacting 127 potential buyers (including 27 financial buyers), 18 preliminary meetings with potential buyers, and, when the representative of one of the plaintiffs expressed interest in submitting a bid, the board accommodated them. Additionally, the opinion notes that the process – beginning in September 2016 and concluding in September 2017 – took a full year, longer than both the nine-month process in *In re Morton's Rest. Gp., Inc. S'holder Litig.* and the seven-month process in *Synthes*, two prior Delaware cases the Court looked to as precedent.

Recognizing that neither the number of contacts with potential buyers nor the length of the sales process was dispositive that a conflict did not exist, the Court was persuaded that the "vigorous" negotiations represented that an arms'-length transaction had occurred and found the process was "indicative that Carlyle was not driven by a liquidity pressure to sell off Authentix for less than fair value." This underscores the importance of engaging in, and documenting, a thorough sales process – particularly where a controlling stockholder is involved.

A Negative Pleading Outcome Can Be Overcome

Of note, the litigation first arose in 2022 when, at the pleading stage, the Court found that plaintiffs had presented sufficient evidence to support "a reasonable inference that Carlyle derived a unique benefit from the timing of the [s]ale not shared with other common stockholders, rendering [Carlyle] conflicted." As a result, the Court rejected Carlyle's motion to dismiss and permitted the case to proceed to trial. However, following the trial, the Court ruled in Carlyle's favor, finding no conflict of interest that would trigger entire fairness, and instead applying the business judgment standard.

While it may have been common for a defendant in Carlyle's position to look to settle the matter once the motion to dismiss was denied, Carlyle elected to stand firm and ultimately obtained its desired result at trial. A key takeaway for potential future defendants is that a ruling against them at the pleading stage does not necessarily mean defeat. As the Court noted, the legal standards at the motion to dismiss stage and at trial are significantly different. In certain circumstances, a controlling stockholder, by having engaged in a thorough, non-crisis driven sales process, has the ability to resist the pressure to settle after losing at the motion to dismiss stage of litigation.

* * * *

Fiduciary duty claims often ratchet up the pressure and are a serious concern in transactions involving controlling stockholders. Although there have been several recent high-profile conflicted transaction cases in Delaware, the Court in *Manti v. Carlyle* demonstrates that there is a true distinction between a controller-led sales process and a conflicted transaction, and that a well-handled and well-documented sales process remains a powerful defense to charges of conflict.

FTC & DOJ: Board Observers Are Subject to the Antitrust Laws' Prohibition on Interlocking Directorates

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Firms and individuals should recognize this position was adopted by a unanimous commission, including President-elect Trump's designee for FTC Chairman (and current Commissioner), Andrew Ferguson, and Republican-appointed Commissioner Melissa Holyoak.[1]

The antitrust agencies' efforts to identify and break interlocks, broadly defined, are not going to be shelved in the second Trump administration. Notably, the revised reporting rules for transactions subject to the Hart-Scott-Rodino Act include a requirement that filing parties identify certain officers and directors. [2] One purpose of this reporting requirement is to identify interlocks that may impact competition, including interlocks that are not prohibited by Section 8.

The Prohibition on Interlocking Directors And Officers

Section 8 of the Clayton Act prohibits one person from simultaneously serving as an *officer* or *director* of two *corporations* if: (1) each of the "interlocked" corporations has combined capital, surplus, and undivided profits of more than $10,000,000[3]; (2) each corporation is engaged in whole or in part in commerce; and (3) the corporations are "by virtue of their business and location of operation, competitors, so that the elimination of competition by agreement between them would constitute a violation of any of the antitrust laws."

Section 8 provides several exemptions from the prohibition on interlocks for arrangements where the competitive overlaps "are too small to have competitive significance in the vast majority of situations." The purpose of the prohibition is to "avoid the opportunity for coordination of business decisions by competitors and to prevent the exchange of commercially sensitive information among competitors." While the remedy for an illegal interlock is merely to break the interlock, the loss of board representation can be a significant hurdle to protecting an investment in the company.

Section 5 of the FTC Act prohibits "unfair methods of competition." Section 5 prohibits "conduct which, although not a violation of the letter of the antitrust laws, is close to a violation or is contrary to their spirit." Although the text of Section 8 suggests a relatively narrow prohibition – it prohibits only "*a person*" from serving as a *director* or *board-appointed officer* of *corporations* that are *competitors* – according to the Commission, Section 5 prohibits, among other things, "interlocking directors and officers of competing firms not covered by the literal language of the Clayton Act's" prohibition on interlocking directorates. Although there is substantial likelihood that the incoming FTC majority will revise the Biden administration's policy statement on the scope of Section 5, the position articulated in the joint statement of interest (discussed below) suggests it is unlikely that the Commission will adopt a different position with respect to horizontal interlocks.

The Position of the DOJ, and a Unanimous Federal Trade Commission, Is that Board Observers Are and Should Be Subject to the Same Prohibitions as Directors and Officers

In the joint DOJ and FTC "statement of interest" filed in *Elon Musk v. Samuel Altman*, the agencies argue that "section 8 bars relationships that create an interlock regardless of form." The agencies argue:

"[A]n individual cannot evade liability by serving as an 'observer' on a competitor's board. … [A] company or individual cannot use an indirect means to a prohibited end, such as by asking another person to serve as a board observer to obtain entry

to a meeting that is otherwise off limits due to Section 8's ban on interlocks. Such misdirection would undermine Section 8's intent to impose a clear ban on direct involvement in the management of a competitor."

During the first Trump administration, current FTC Commissioner Rebecca Slaughter, and then-FTC Commissioner Chopra argued that Section 5's prohibition on unfair methods of competition reaches interlocks that are defined to include board observer positions. According to Slaughter and Chopra:

"Typically, a board observer is like a regular member of a board of directors, but without a formal vote. While they don't have a vote, they certainly have a say. Like regular board members, board observers often participate in confidential discussions about strategy. Board observers can advocate for a preferred outcome. Board observers can even get access to key data. … I have reason to believe this arrangement undermines a key purpose of Section 8 of the Clayton Act's prohibition on interlocking directorates and [is] therefore unlawful under Section 5 of the FTC Act."

Potential Effect of the U.S. Government's Position

The Statement of Interest adopts the position on board observers on behalf of both the United States and the Commission with respect to the reach of Section 8. This position was adopted by a unanimous commission, including chair-designee Andrew Ferguson and his Commissioner colleague Melissa Holyoak.

The antitrust agencies' efforts to identify and break interlocks, broadly defined, is not likely to dissipate in the second Trump administration, and the position of the United States and the Commission, if adopted by the court, may trigger an expansion of derivative litigation by plaintiff shareholders of the interlocked companies. Even without adoption by the court, the antitrust agencies have articulated an enforcement principle that they are likely to continue to advance beyond the district court.

While the remedy for violating Section 8 is limited to a break of the interlock, an interlock can support the requirements of an agreement for a violation of Section 1 of the Sherman Act (agreements in restraint of trade) or create a factual inference of an ability to collude or coordinate towards anticompetitive behavior. Violations of Section 1 of the Sherman Act can result in substantial private damages or criminal fines.

Section 8 is usually "enforced" by proper board and officer selection screening, not by government enforcement action or private actions. Because the interlocked company is also subject to liability for violating Section 8 and Section 5, director and officer selection efforts should adopt board relationship disclosures that include board observer positions, and companies may wish to adopt guidelines that expand prohibitions on persons serving as directors (or officers) of competing companies to include prohibitions on board observer status at competing companies.

A version of this article was originally produced as a Clients & Friends Memo here.

[1] See Concurring Statement of Commissioner Andrew N. Ferguson Joined by Commissioner Melissa Holyoak Regarding the Statement of Interest Supporting Elon Musk, Musk v. Altman (FTC Matter No. 2323044) (Jan. 8, 2025).

[2] See Bilal Sayyed, FTC Substantially Expands HSR Merger Notification Form's Information and Documentary Requirements (Quorum Newsletter, October 2024).

[3] 15 U.S.C. §19. The $10,000,000 threshold is adjusted annually and is presently $48,559,000. It will soon be adjusted upward to $51,380,000. See Client & Friends Memo, *FTC Announces 2025 Thresholds for Merger Control Filings Under HSR Act and Interlocking Directorates Under the Clayton Act* (Jan. 13, 2025).

Corporate Transparency Act Remains on Hold Despite SCOTUS Stay of Injunction


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On January 23, 2024, the Supreme Court overturned a nationwide injunction enjoining enforcement of the Corporate Transparency Act ("CTA"). However, the implementing regulations of the CTA remain unenforceable due to a district court order still in effect in a separate case.

On December 3, 2024, a judge of the U.S. District Court for the Eastern District of Texas issued a nationwide preliminary injunction in *Texas Top Cop Shop, Inc., et al. v. Garland*, enjoining the federal government from enforcing the CTA, its implementing regulations, and its reporting deadlines after finding that Congress likely exceeded its authority in enacting the law.[1]

On December 23, 2024, a three-judge motions panel of the Fifth Circuit stayed the injunction.[2] On December 26, 2024, a Fifth Circuit merits panel vacated the portion of the motions panel's order that stayed the injunction, causing the injunction to go back into effect.[3] On December 31, 2024, the government applied to Justice Samuel Alito for a stay of the injunction.[4] Justice Alito referred the application to the full Supreme Court, which granted the stay on January 23, 2025.[5]

However, a federal district court order blocking enforcement of the CTA's implementing regulations in a different case is still in effect. On January 7, 2025, in *Smith v. U.S. Department of the Treasury*, a different judge of the U.S. District Court for the Eastern District of Texas found the CTA is likely unconstitutional and stayed the effective date of the CTA's implementing regulations, including the requirement to file beneficial ownership reports.[6] That stay remains in place, and the government has not yet appealed.

A FinCEN alert published after the Supreme Court's January 23, 2025 order states that "[a]s a separate nationwide order issued by a different federal judge in Texas (*Smith v. U.S. Department of the Treasury*) still remains in place, reporting companies are not currently required to file beneficial ownership information."[7] FinCEN also stated that reporting companies may continue to voluntarily submit their reports.[8]

The constitutionality of the CTA has been challenged in several other courts. The issue is on appeal in the Eleventh Circuit, where a U.S. district court in Alabama found the CTA unconstitutional.[9] However, in Michigan, Oregon, and Virginia, U.S. district courts have denied preliminary injunctions with respect to the CTA.[10]

The government's appeal in the Fifth Circuit remains on an expedited track, with oral argument scheduled for March 25, 2025.[11]

We will continue to monitor developments related to the enforceability of the CTA.

A version of this article was originally produced as a Clients & Friends Memo here.

[1] *Texas Top Cop Shop, Inc. v. Garland*, No. 4:24-CV-478, 2024 WL 4953814 (E.D. Tex. Dec. 3, 2024).

[2] Unpublished Order, *Texas Top Cop Shop, Inc. v. Garland*, No. 24-40792 (5th Cir. Dec. 23, 2024), ECF No. 140-2.

[3] Order, *Texas Top Cop Shop, Inc. v. Garland*, No. 24-40792 (5th Cir. Dec. 26, 2024), ECF No. 160-2.

[4] Application for a Stay of the Injunction Issued by the United States District Court for the Eastern District of Texas, *Garland v. Texas Top Cop Shop, Inc.*, No. 24A653 (Dec. 31, 2024).

[5] On Application for Stay, *Garland v. Texas Top Cop Shop, Inc.*, No. 24A653 (Jan. 23, 2025).

[6] Memorandum Opinion and Order Granting Motion for Preliminary Relief, *Smith v. U.S. Dep't of the Treasury*, No. 6:24-cv-336-JDK (E.D. Tex. Jan. 7, 2025), ECF No. 30.

[7] *Beneficial Ownership Information*, FinCEN, available at https://fincen.gov/boi (last accessed Jan. 24, 2025).

[8] *Id.*

[9] Notice of Appeal, *Nat'l Small Bus. United v. Yellen*, No. 5:22-CV-1448-LCB (N.D. Ala. Mar. 11, 2024), ECF No. 54.

[10] Case Management Order, *Small Bus. Ass'n. of Mich. v. Yellen*, No. 1:24-cv-314 (W.D. Mich. Apr. 26, 2024), ECF No. 24; Notice of Appeal, *Firestone v. Yellen*, No. 3:24-CV-1034-SI (D. Or. Nov. 18, 2024), ECF No. 19; Notice of Appeal, *Cmty. Associations Inst. v. Yellen*, No. 1:24-CV-1597 (MSN/LRV) (E.D. Va. Nov. 4, 2024), ECF No. 41.

[11] Clerk's Memorandum, *Texas Top Cop Shop, Inc. v. Garland*, No. 24-40792 (5th Cir. Dec. 26, 2024), ECF No. 165-2.

Delaware Court Reins in Insurer's Use of "Bump-Up" Exclusions to Deny Coverage Under D&O Policies


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The so-called "bump-up" exclusion that insurers have increasingly relied on to deny coverage under director and officer (D&O) policies was recently narrowed by the Delaware Superior Court in *Harman International Industries Inc. v. Illinois National Insurance*; decided on January 3, 2025.

A company will customarily indemnify directors and officers for losses incurred in connection with actions and omissions in furtherance of such person's service to the company. The company will then typically obtain a D&O insurance policy to cover the entity and its directors and officers, including for these indemnified losses. As M&A deal litigation has accelerated in recent years, D&O insurers have increasingly pushed to include bump-up exclusions in policies and relied on these exclusions to deny coverage. Bump-up exclusions allow an insurer to reject coverage where there are allegations that the insured target company sold for a below-market price and, as a result of a judgment or settlement of such allegations, the consideration paid to the target company or its stockholders in the underlying deal is increased or "bumped up." Historically, bump-up exclusions in D&O insurance policies were used to prevent buy-side insureds from colluding with the target company and its board of directors to accept less than market value and off-load to insurance providers the risk that target company stockholders bring claims alleging insufficient consideration. In recent years, D&O insurers have drafted bump-up exclusions broadly to deny coverage for judgments and settlements that may be even indirectly related to the consideration paid in an acquisition.

Prior to the Delaware Superior Court's decision in *Harman*, courts in Delaware and other jurisdictions assessed the use of bump-up exclusions in connection with settlements of M&A related litigation, but judicial decisions generally focused on the precise use of the term "acquisition" (the operative text of bump-up exclusions in D&O policies often permit the insurer to deny coverage for losses in connection with claims that consideration paid for an "acquisition" was inadequate).

In *Towers Watson & Company v. National Union Fire Insurance Company of Pittsburgh*, the U.S. District court for the Eastern District of Virginia found that a bump-up exclusion applied to a merger of equals based on a broad reading of the terms "acquisition" and "entity" in the insurance policy. Following Towers Watson's merger with Willis Group Holdings plc, Towers Watson stockholders brought litigation alleging inadequate consideration for their shares in the merger. The stockholder suits settled, and Towers Watson's insurer refused indemnity coverage under the policy's bump-up exclusion. The Virginia Court sided with the insurer finding that the bump-up exclusion unambiguously applied to the settlements, permitting the insurer to deny coverage under the policy because: (1) the underlying stockholder actions alleged inadequate consideration; (2) Towers Watson itself was an "entity" that could be subject to an "acquisition," which, the Virginia court concluded, includes a merger; and (3) the settlements represented an effective increase in the consideration for merger.

Conversely, in *Viacom Inc. v. U.S. Specialty Insurance Company*, the Delaware Superior Court refused to apply a bump-up exclusion to an all-stock merger where the terms "merger" and "acquisition" were separately defined in the policy. After Viacom merged into CBS Corp., Viacom stockholders asserted breach of fiduciary duty claims against Viacom's board of directors, officers and controlling stockholders, and alleged that the stock-for-stock exchange ratio in the transaction

was inadequate. The litigation ultimately settled for $122.5 million, but Viacom's D&O insurer refused to cover this settlement arguing that the merger constituted an "acquisition" that was subject to the bump-up exclusion in Viacom's D&O policy. Viacom argued that the bump-up exclusion did not apply to this merger because the policy separately defined "acquisitions" and "mergers," and only the term "acquisition" was used in the bump-up provision. The Delaware Superior Court found both the insurer and Viacom's interpretations reasonable and, consistent with Delaware precedent, held that "[i]f there is any ambiguity, it should be resolved in favor of the insured, as it is incumbent on the drafter of the insurance agreement to be unequivocally clear in carving out exclusions to coverage."

As it did in *Viacom*, the Delaware Superior Court sided again with the insured company in *Harman* and ordered the insurer to provide coverage under the D&O policy. However, this time the Court focused more on the underlying claims made and basis for the settlement. Stockholders of Harman International Industries, Inc. brought a class action suit under Sections 14(a) and 20 of the Securities Exchange Act of 1934, alleging that the proxy statement filed in connection with the sale of Harman to Samsung Electronics Co. in 2017 was false and misleading, and caused the aggrieved stockholders not to exercise appraisal rights. More specifically, the stockholders claimed Harman negligently disseminated a misleading proxy statement that "induced [stockholders] to vote their shares and accept inadequate consideration" and "deprived [stockholders of their] right to a fully informed shareholder vote . . . and the full and fair value for [their] shares." The plaintiffs sought compensatory and/or rescissory damages against Harman and other parties. When Harman first approached its D&O insurer, the insurer acknowledged that the action was a securities claim covered by the policy. However, while the case was continuing, Harman's insurer sent a second letter stating that it would deny coverage for any judgment or settlement of the stockholder class action based on the bump-up exclusion in Harman's D&O policy.

The stockholder case later settled "to avoid costly litigation" and Harman denied any wrongdoing. Consistent with its second communication, Harman's insurer refused coverage arguing that the settlement of the class action effectively "bumped up" the sale price of the underlying transaction.

Relying on *Viacom* and other previous decisions, the insurer argued the transaction was an "acquisition" and that the settlement resulted in increased consideration paid. Although the Court agreed that the transaction was an "acquisition" and thus the bump-up provision applied to litigation settlements related to Samsung's acquisition of Harman, the class action did not seek "to remedy inadequate deal price" and therefore a settlement of such class action would not effectively increase consideration.

The Delaware Superior Court stated that:

"For the Bump-Up to exclude any settlement or portion thereof: (1) the settlement must be related to an underlying acquisition; (2) inadequate deal price must be a viable remedy that was sought for at least one claim in the [underlying a]ction; and (3) the settlement, or a portion of the settlement, must represent an effective increase in consideration."

Finding only one of the three prongs met (that the transaction was an "acquisition"), the Court sided with Harman. The Court noted that increasing deal consideration is not a remedy available to plaintiffs alleging violations of the federal securities laws' proxy statement rules. A "bare request of relief for inadequate price isn't enough; the court in the underlying action must also be authorized to remedy the inadequate deal price under the claims raised." Further, the settlement did not itself represent an effective increase in the consideration for the transaction and the parties acknowledged that the settlement "was based solely on the conclusion that further conduct of the Litigation would be protracted and expensive." Satisfied with this rationale, the Court found that "[a]voiding the cost of further litigation is a valid reason to settle and the Court has no reason to believe this reasoning was pretextual." Although the plaintiff stockholders did not present any evidence of true value or an adequate sales price, the Court estimated, based on the complaint, that a potential appraisal calculation could net over $279

million in damages for the class and held that the $28 million settlement price more closely resembled the legal fees saved.

These decisions in *Harman* and *Viacom* exhibit Delaware's bent toward insureds and permitting insurers to use bump-up exclusions only in limited circumstances. Although the Court in *Harman* gave deference to the reasons stated by Harman in the stipulation of settlement and litigation documents (to which the insurer was not a party), the opinion notes that it did so because the Court did not believe the reasons stated in such documents were pretextual. There is no guarantee that Delaware courts will give similar weight to settlement documents in future litigation. Going forward, D&O insurers and insured companies alike should carefully draft and negotiate bump-up exclusions in their D&O policies to eliminate ambiguity.

DOJ Allegations that KKR Systematically Failed to Comply With the HSR Act – Highlights Importance of DOJ Corporate Compliance Guidelines

By **Bilal Sayyed**
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The Department of Justice ("DOJ") has alleged in a complaint filed in the Southern District of New York on January 14, 2025 that KKR & Co. Inc. and certain of its investment advisors and funds (collectively, "KKR") "systematically flouted the [notification and reporting] requirements of the Hart-Scott-Rodino Act[1] ("HSR Act" or "Act") by: (1) failing to make an HSR filing for two transactions; (2) altering documents in HSR filings for eight transactions; and (3) "systematically omitting required documents" in HSR filings for ten transactions. The maximum civil penalty for these violations, according to the DOJ, is greater than $650 million. DOJ has also reportedly opened a criminal investigation. KKR responded by filing its own complaint against DOJ the same day, seeking a court ruling that it did not violate the HSR Act.

Firms and persons – particularly "serial acquirers" – should not rely on the agencies' enforcement discretion in seeking civil penalties when evaluating and managing their HSR Act compliance risk. A comprehensive good faith HSR compliance program can be developed within the framework of existing DOJ and FTC guidance.

"Serial" HSR Filers Should Look to Recent DOJ Guidance on Evaluation of Criminal Compliance Programs for Development of HSR Compliance Programs

DOJ alleges that KKR "failed to maintain sufficient controls over its HSR filing practices" and that:

- It provided inadequate training to employees involved in collecting responsive documents and certifying HSR filings;
- Deal teams failed to search the files of certain directors or officers for relevant documents for the HSR filings; and
- Senior executives who were responsible for certifying under penalty of perjury that each HSR filing was true, correct and complete and prepared under that executive's supervision failed to review complete and final versions of the filings prior to signing the certifications.

DOJ's *Evaluation of Corporate Compliance Programs* ("*Evaluation of Criminal Compliance Programs*") and *Evaluation of Corporate Compliance Programs in Criminal Antitrust Investigations* ("*Evaluation of Antitrust Compliance Programs*") (collectively "Compliance Guidance") is relevant for designing and implementing an effective HSR compliance program. KKR's course of conduct (as alleged) appears to fail the three "fundamental questions" DOJ considers in evaluating a corporate compliance program: (1) is it well designed; (2) is the program being applied earnestly and in good faith; that is, is it adequately resourced and empowered to function effectively; and (3) does it work in practice? *Evaluation of Criminal Compliance Programs* at 1-2.

The Compliance Guidance "assist[s] prosecutors in making informed decisions as to whether, and to what extent, [a] corporation's compliance program was effective." It is relevant to the investigation, evaluation and settlement of civil antitrust matters and provides a framework for the design of an effective compliance program. Counsel – whether in-house or outside counsel – may wish to consult it to design and implement an effective compliance program.

The Compliance Guidance identifies nine elements of an effective compliance program: (1) design and comprehensiveness; (2) culture of compliance; (3)

responsibility for the compliance program; (4) risk assessment; (5) training and communication; (6) periodic review, monitoring and auditing; (7) confidential reporting structure and investigation process; (8) incentives and discipline; and (9) remediation and role of the compliance program in the discovery of the violation. We previously discussed each of these nine factors in the December Quorum newsletter.[2]

Identification and Adoption of Possible Best Practices for the Serial Acquirer

A "serial acquirer" may consider adopting the following practices to better align its HSR compliance efforts with the Compliance Guidance:

- a comprehensive, written HSR compliance program/manual;
- introductory and annual training for personnel with transaction related responsibilities, including personnel who identify and evaluate transaction targets, and who negotiate transactions;
- designation of an internal legal counsel (who reports to the General Counsel or Chief Legal Officer) with responsibility for HSR compliance, with early access to deal-team members, the ability to do (or request) an early evaluation of (a) the structure of the transaction, (b) whether and under what conditions the transaction will be reportable, (c) the substantive antitrust issues associated with the transaction, and (d) the ability and responsibility to manage and oversee the creation, distribution and collection of deal-related documents within the company and among third-party advisors on the transaction;
- a consistent process for the collection and evaluation of documents for possible inclusion with the HSR filing, including procedures for confirming documents have not been missed because of a failure to identify relevant individuals, locations, or mere oversight;
- guidelines to distinguish "draft" documents from final documents, the identification and description of proper document creation principles, and the identification of a central repository for deal-related documents;
- guidelines on the destruction of deal-related documents, including when it is appropriate, when it is not, and what approvals must be sought prior to destruction;
- identification of non-company channels that create opportunities for creation and distribution of documents; *g*., personal emails, personal devices, and identification of a plan for prohibiting the use of non-company channels, or a process for review of and collection from such channels;
- use of software and AI tools to identify documents, and modifications to documents, as they are circulated within or outside the company;
- one-on-one discussions with deal-team members who may self-search or self-pull documents to confirm their understating of the scope of the request for documents and scope of HSR compliance requirements with respect to the transaction being notified;
- post-transaction, post-filing review and evaluation of HSR compliance efforts;
- confidential, internal reporting channels to HSR compliance designee or General Counsel of intentional disregard of HSR compliance;
- process to monitor potential and/or upcoming filing obligations;
- process to quickly identify and remediate misidentify missed HSR filings; and,
- a process for reviewing and monitoring adherence to the HSR compliance guidelines, and the identification and imposition of penalties for intentional efforts to act in violation of the guidelines.

These suggestions draw from the DOJ's Compliance Guidelines framework, and the FTC's evaluation of post-consummation filings and are suggestions for, and not necessarily requirements of, an effective HSR compliance program. A company may tailor its HSR compliance program to its more general operations and broader legal and regulatory compliance efforts, but the Compliance Guidelines set out a framework against which any such compliance program will likely be evaluated. Deviations from the general framework may require explanation, if a compliance issue comes to the government's attention.

[1] Under the HSR Act, parties involved in proposed mergers, acquisitions of voting securities, unincorporated interests or assets, or other business combinations (*e.g.*, joint ventures, exclusive license deals) that meet certain thresholds must report the proposed transaction to the Antitrust Agencies unless an exemption applies. The parties to a proposed transaction that requires notification under the HSR Act must observe a statutorily prescribed waiting period (generally thirty days) before closing. The jurisdictional thresholds are adjusted on an annual basis. *FTC Announces 2025 Thresholds for Merger Control Filings Under HSR Act and Interlocking Directorates Under the Clayton Act* (Jan. 13, 2025). A failure to comply with the HSR Act is subject to a civil penalty for each day a person is not in compliance; at present, the maximum daily civil penalty is slightly over $53,000. *Adjustments to Civil Penalty Amounts*, 90 FR 5580 (Jan. 17, 2025).

[2] Bilal Sayyed, *Corporate Compliance Programs: Updated DOJ Guidance in Antitrust Investigations* (Quorum Newsletter, Dec. 2024).

SEC Brings Suit Against Elon Musk for Failure to Report Twitter Ownership


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On January 14, 2025, the U.S. Securities and Exchange Commission (the "SEC") sued Elon Musk over his 2022 acquisition of Twitter, Inc. stock and alleged failure to timely disclose a 5% ownership stake in Twitter, as required by federal securities laws.

Musk, the SEC alleges, violated Rule 13d of the Securities Exchange Act of 1934 by failing to report his beneficial ownership of more than 5% of Twitter's common stock within 10 calendar days of acquiring such ownership stake, as was required by Rule 13d-1(a) at the time of the alleged violation.[1] The SEC claims that Musk delayed his disclosure by 11 days, missing a March 24, 2022 deadline and allowing him to purchase an additional $500 million worth of Twitter stock between March 25, 2022 and April 1, 2022 "at artificially low prices from the unsuspecting public, who had not yet priced in the undisclosed material information of Musk's beneficial ownership…and investment purpose."

Musk filed an initial Schedule 13G on April 4, 2022, revealing a 9.2% stake. Although the initial Schedule 13G was filed under Rule 13d-1(c), which permits a person who would otherwise be obligated to file a Schedule 13D to instead file a short-form statement on Schedule 13G if that person "[h]as not acquired the securities with any purpose, or with the effect, of changing or influencing the control of the issuer, or in connection with or as a participant in any transaction having that purpose or effect," Musk subsequently converted to a Schedule 13D on April 5, 2022. This Schedule 13D stated that Musk entered into an agreement with Twitter (1) appointing Musk to Twitter's Board of Directors and (2) restricting Musk from acquiring beneficial ownership in Twitter in excess of 14.9%.[2]

According to the SEC's complaint, when Musk did eventually publicly report his ownership, Twitter's share price rose more than 27%. The SEC argues that by neglecting to timely file the beneficial ownership report, Musk profited $150 million at the expense of Twitter shareholders who sold without knowledge of Musk's stake or plans. The lawsuit seeks to impose a civil fine on Musk and require him to disgorge these profits.

Through the beneficial ownership reporting requirements, the SEC aims to help investors make informed decisions by requiring disclosure about accumulations of securities that may change or influence control of the issuer company. Rule 13d imposes strict liability on violators and, at the time of Musk's violation, would have required Musk to disclose within 10 calendar days of acquiring more than 5% beneficial ownership in Twitter. In October 2023, the SEC adopted amendments to this rule, including accelerated filing deadlines, and now requires 13D and certain 13G filings within five business days of crossing 5%. According to the SEC, the amendments modernize the reporting regime to keep up with technological evolution and protect investors by reducing information asymmetry in the fast-moving markets.

Musk's lawyers called the SEC lawsuit the culmination of a "multi-year campaign of harassment" against his client, further describing the case a "sham."

This action comes just a month after a Delaware Court of Chancery judge again ruled that Musk is not entitled to receive a $56 billion compensation package from Tesla, Inc. The Court of Chancery ruling is the latest in the ongoing dispute regarding the fairness and structure of Musk's pay package, which is performance-based with incentives triggered by ambitious company growth targets. The plaintiff

argued that the package was excessive and not properly aligned with Tesla's performance or the interests of shareholders. Chancellor McCormick highlighted Musk's controlling shareholder position at Tesla as a potential conflict of interest and found that the board "failed to prove that those terms [of the pay package] were entirely fair."

This is the second time that Delaware courts have struck down the pay package. Although shareholders first approved the multi-billion-dollar option grant in 2018, in January 2024 the Delaware Court of Chancery ruled against the package in part because the judge reasoned the Tesla board was potentially beholden to Musk when it approved of the arrangement. Subsequent to this decision, Tesla again presented the pay package to shareholders who ratified Musk's options with an over 70% approval. Tesla then re-approached the Court and argued that the Court should recognize the shareholder ratification and reverse its prior decision. Writing the Court of Chancery opinion, Chancellor McCormick held that a company cannot ratify a conflicted controller transaction after a judicial decision to cure a conflict, noting that "were the court to condone the practice of allowing defeated parties to create new facts for the purpose of revising judgments, lawsuits would become interminable."

Not only did Chancellor McCormick again reject the pay package, she ordered Tesla to pay the plaintiff's attorneys $345 million in legal fees, specifying the fee could be paid in cash or Tesla stock.

Of note, the SEC complaint is based on the timeliness of Musk's eventual disclosure and not whether he was eligible to file the Schedule 13G he initially did, or if he should have filed from the beginning on Schedule 13D. However, the complaint highlights conversations Musk had with the Twitter board prior to filing his 13G where he expressed an interest in becoming a director. It remains to be seen whether Musk will appeal the Court of Chancery's decision or how Musk and his attorneys will respond to the SEC complaint and if so, whether these other facts will become an area of focus.

[1] As described below, the deadline is now five business days as a result of amendments adopted in October 2023.

[2] Musk subsequently amended the Schedule 13D, including on April 11, 2022 and April 14, 2022, the latter of which disclosed Musk's initial non-binding proposal to acquire all of the outstanding common stock of Twitter.