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July 2024

THE POTENTIAL IMPACT OF THE DGCL MARKET PRACTICE AMENDMENTS ON ACTIVISM SETTLEMENTS

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On July 17, 2024, Senate Bill 313, the market practice amendments to the Delaware General Corporation Law (the "*DGCL*"), were signed into law by Delaware Governor John Carney and are now incorporated into the DGCL. Prior to such time, the debate had already begun over how the market practice amendments would impact companies' settlements with activist investors and whether the "floodgates" would be opened for more expansive demands from activists in connection with such settlements.

Since at least the early 2000's, activism settlement agreements (also known as cooperation agreements) have become relatively standardized in overall form with the key feature being that the company's board agrees to appoint and/or nominate and recommend to shareholders one or more activist recommended director candidates and, following the appointment by the board or election by the shareholders, to appoint such director candidates to one or more existing or new board committees. In return, the activist agrees to withdraw its notice of nominations and terminate its proxy contest, agrees to various standstill and other restrictive covenants for a limited period of time, and agrees to vote for the company's slate of director nominees which would include the activist's recommended director candidates. The company may also agree to various other provisions such as a limit on the size of the board during the standstill

period, certain governance reforms requested by the activist such as declassification of a classified board, and expense reimbursement for the activist.

Earlier this year, the Delaware Court of Chancery issued its decision in *West Palm Beach Firefighters' Pension Fund v. Moelis & Co.* (Feb. 23, 2024)[1] ("*Moelis*") and invalidated a governance agreement as unlawfully limiting the discretion of a company's board of directors in violation of Section 141(a) of the DGCL. While the *Moelis* decision did not involve an activism settlement, it created some uncertainty with regards to whether activism settlements also unlawfully limited the discretion of a company's board of directors in violation of Section 141(a) of the DGCL. Accordingly, the *Moelis* decision was viewed as a potential threat to the longstanding activism settlement model. While the market practice amendments can be seen as restoring the status quo that existed prior to the *Moelis* decision, the unresolved question is whether activists will be emboldened to seek in activism settlements the type of governance restrictions and pre-approval or veto rights that were questioned in the *Moelis* decision.

While the market practice amendments could result in some activists seeking (which is not the same as actually getting the company to agree) heretofore novel governance restrictions and pre-approval rights in an activism settlement, an important point is missing from the ongoing debate that casts some doubt that activists will, in the near-term, use the market practice amendments as an opportunity to expand upon the traditional activism settlement model. Prior to the *Moelis* decision, it is likely that most activists and their advisors did not believe that there was any potential conflict between the longstanding activism settlement model and Delaware law. The same is likely the case on the company side as well. If you attended the Tulane Corporate Law Institute conference in New Orleans this past March, the *Moelis* decision was top-of-

[1] West Palm Beach Firefighters' Pension Fund v. Moelis & Co., No. 2023-0309-JTL (Del. Ch. Feb. 23, 2024)

mind, and almost every advisor I talked to, both on the company and the activist side, was taken by complete surprise by the *Moelis* decision and the cloud it cast on the longstanding activism settlement model. Accordingly, prior to the *Moelis* decision, it may very well be the case that most activists and their advisors did not believe, and had no reason to believe, they were constrained by any potential conflict with Delaware law in what they sought or considered seeking from companies in activism settlements.

In the recent activism settlement agreements that I have seen, both as an activism defense advisor and a regular observer of all things related to shareholder activism, activists, not believing they were constrained by any potential conflict with Delaware law, have been focused on traditional demands like board representation, representation on existing and new committees, limits on the size of the board for a limited duration of time, corporate governance changes to the extent applicable (e.g., declassification of a classified board), and expense reimbursement. Of course, there have been settlements where the activist makes additional demands. However, I have not seen any trend where activist settlement demands have been expanding such that activists have been looking for more control over the governance and operations of the company other than what is achieved through board and committee representations, including the establishment of new committees such as strategic and operations review committees. Specifically, I am not aware of any noticeable trend where, prior to the *Moelis* decision, activists had been seeking to have activism settlement agreements provide them with pre-approval or veto rights similar to those that were at issue in the *Moelis* decision such as pre-approval or veto rights over (i) the issuance of debt or equity, (ii) entry by the company into new lines of business, (iii) the removal or appointment of officers, (iv) the adoption of budgets and business plans and any material amendments thereto, (v) the declaration and payment of any dividends, (vi) the entry into any merger or business combination agreements, (vii) the entry into or material amendment of any material contract, or (viii) the initiation or settlement of any lawsuits. To be clear, there are activists that seek, through board and

committee representation, to ultimately control, or effectively control, the company and, through such control, have substantial influence over the foregoing items, but that is not equivalent to pre-approval or veto rights.

If activists were not focused on expanding what they received in an activism settlement pre-*Moelis,* when they were not factoring in any potential conflict with Delaware law, it would be logical to expect that, when the potential threat to the longstanding activism settlement model is addressed by the market practice amendments, we should be returned to the pre-Moelis status quo, at least with regards to what we see in activism settlement agreements.

The market practice amendments and the related legislative history may create other issues over time for activism settlement agreements[2] and the 2025 proxy season may reveal some of them, some predictable and some not, but, at the moment, I do not believe the top issue to be concerned with is whether, as a result of the market practice amendments, we will observe a noticeable trend where activism settlement agreements will evolve to include more governance restrictions and pre-approval or veto rights such as the ones that were called into question in the *Moelis* decision. That said, I am sure some activists will be emboldened to request heretofore novel demands in connection with their settlement discussions which could include some governance restrictions and pre-approval or veto rights. However, I am doubtful any such approach would gain significant traction in the near term. Were activists to take such an

[2] The synopsis to Senate Bill 313 notes that the new § 122(18) does not relieve any directors, officers or stockholders of any fiduciary duties they owe to the corporation or its stockholders, including with respect to deciding to cause the corporation to enter into a contract with a stockholder or beneficial owner of stock and with respect to deciding whether to perform, or cause the corporation to perform, or to breach, the contract. This language may be an invitation for the Delaware courts to look more closely at the process that a board followed in approving an activism settlement agreement and we may eventually see further guidance from the Delaware courts on how a board's compliance with its fiduciary duties is analyzed in the activism settlement context. The scrutinization of a board's process for approving an activism settlement agreement (and not the significant expansion of activists' settlement demands to include heretofore novel governance restrictions and pre-approval or veto rights) could possibly be the proverbial "Pandora's box" that is opened as a result of the market practice amendments.

approach, it is likely that we would see settlements take longer to be reached and they would occur less frequently. In addition, notwithstanding that the market practice amendments would effectively neuter the *Moelis* decision, it is likely that settlements with novel pre-approval or veto rights would eventually end up being scrutinized by the plaintiffs' bar and, thereafter, the Delaware courts. None of that would be favorable to activists who favor quick resolution of their activism campaigns and have benefitted greatly from the current, longstanding settlement model, a model which been recently aided by the Securities and Exchange Commission's promulgation of Rule 14a-19, the universal proxy rule, and the pressure such rule puts on a public company to settle with an activist.

About Gottfried Shareholder Advisory LLC

Gottfried Shareholder Advisory LLC is a strategic advisory firm focused on advising public companies and their boards of directors on shareholder activism preparedness and defense. More information about the firm is available at our website.