Skadden

The Informed Board

Spring 2025

In this issue of *The Informed Board*, we go behind all the talk about companies reincorporating in states other than Delaware. In our lead article and our podcast, we point out that few companies actually moved, and we explain why Delaware retains its dominance as the jurisdiction for incorporation.

Meanwhile, a change of policy at the SEC is making institutional shareholders cautious about expressing their views to management for fear they will be forced to file burdensome ownership statements. We explain how companies can adjust their approach to shareholder engagement in order to give shareholders the information they want but may no longer feel free to ask for.

Finally, in interviews with two veteran directors, we glean firsthand lessons about planning and pulling off a spinoff, and about weighing the right mix of experience and skills needed for a board.

Delaware Tells Companies: 'Let's Stay Together'

- Significant amendments to Delaware's corporate law create safe harbors for companies and directors, limiting challenges to deals and protecting directors from liability for approving deals if specified procedural steps are taken.
- The changes were made to address criticisms that prompted some Delaware companies to consider reincorporating in other states.
- Other statutory changes clearly define what constitutes an independent director and a controlling shareholder, and limit the types of books and records stockholders can demand to see — all areas where litigation has mushroomed in recent years.

Over the past few years, Delaware corporations law has been criticized for lacking certainty and predictability in the standards associated with transactions, particularly ones where conflicts arise. This has coincided with an uptick in public discussion over a possible exodus of Delaware companies to other states. But few major companies have reincorporated elsewhere and the alleged shortcomings of Delaware law were seldom relevant to most public companies. They mainly affected companies with controlling stockholders.

Whatever the merits of the criticisms, they have been laid to rest by amendments this spring to the state's corporation law that clarify and simplify the procedures for approving transactions involving controlling stockholders, or where directors or management have conflicts. The amendments create procedural safe harbors that should protect those deals from challenge and insulate directors, officers and controlling stockholders from liability if the statutory steps are followed.

The changes also clarify what constitutes a disinterested director, and a controlling stockholder or controller group. These terms, which were not previously defined by statute, had generated a great deal of litigation in recent years.

In addition, the kinds of company documents that stockholders can access outside of the discovery process in litigation have now been restricted, making it hard for stockholders to obtain informal communications such as texts and emails before filing suit.

In short, the new statutory definitions and standards provide greater clarity and certainty for transactions involving conflicts and for books and records demands. The changes should make it easier for companies to plan transactions that will fall within the new statutory safe harbors, and efficiently resolve books and records demands, avoiding unnecessary litigation costs.

There are many reasons Delaware has been a mecca for companies. The state's courts have a well-deserved reputation for being business savvy and reaching decisions quickly. And the amendments highlight the importance the executive and legislative branches of Delaware's government place on keeping the state's corporations law in tune with business realities.

So why all the public talk of reincorporation? Here are answers to some basic questions.

Delaware's Continued Dominance

S&P 500 companies that have left Delaware since January 2020: **2** (Tesla, TripAdvisor)*

S&P 500 companies that have moved to Delaware since January 2020: **3** (including Cisco and Caesars Entertainment)

Portion of S&P 500 companies incorporated in Delaware: **67.6%**

Publicly traded entities incorporated in Delaware in 2024: **2,451** (+85 over 2023)

IPO companies incorporated in Delaware in 2024: **80%**

*TripAdvisor dropped out of the index before its reincorporation was completed. Excludes WestRock, which reincorporated in Ireland when it merged with an Irish company.

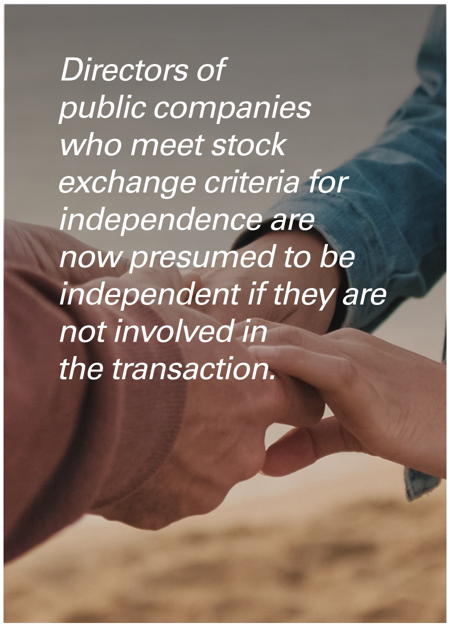
Sources: Deal Point Data; Delaware Secretary of State

What were the complaints about Delaware law?

Delaware law has long protected minority stockholders in transactions involving a controlling stockholder, and where directors' or officers' interests could conflict with other stockholders (*e.g.*, in a take-private where management is going to be retained). But there were complaints that, as the law had evolved, it was impeding legitimate transactions by setting unrealistically high independence standards for directors and demanding disclosures that were not clearly material.

In practice, virtually every transaction involving controlling stockholders was challenged in court, and many suits alleged (often with little factual basis) that directors who the company considered independent of management and controlling stockholders were not independent for purposes of approving transactions with possible conflicts. And the law had developed so that many of the issues could not be dealt with at an earlier, pleading stage of the lawsuit.

Stockholders' requests for pre-litigation access to corporate books and records had also become long, drawn out affairs and, in many cases, had turned into pre-lawsuit mini-discovery. This also spawned a significant amount of litigation over the scope of those requests. Companies found themselves spending significant amounts of time, money and focus on fighting over a process that had long been viewed as routine and limited.



What's changed for directors?

Under the amendments, directors of public companies who meet stock exchange criteria for independence are presumed to be independent if they are not involved in the transaction — even those named to the board by a person with an interest in the transaction. This presumption is "heightened" and can only be rebutted by "substantial and particularized facts" that a director has a material interest in the act or transaction, or has a material relationship with an interested party.

This change will make it much harder to challenge the independence of directors on dubious grounds.

The amendments also set out clear definitions of a controlling stockholder and a control group which, likewise, should reduce litigation.

How does this affect transactions where there may be conflicts? How do the safe harbors work?

Under the revised statutes, in most cases, where the interests of a controlling stockholder, controlling group, directors or officers may diverge from those of other stockholders, the deal can be "cleansed" if ***any*** *one of these three conditions is met*:

- The transaction is approved or recommended in good faith by a majority of directors on a committee with at least two disinterested directors.
- The deal is approved by a majority of fully-informed and disinterested stockholders.
- The transaction is fair to the corporation and its stockholders.

In the case of controlling stockholder (as now defined) take-private transactions, the standard is higher: Those must (a) be approved by both disinterested directors *and* stockholders, *or* (b) be fair to the corporation and stockholders. Before the amendments, the Delaware courts had applied this higher standard to *all* deals or decisions involving controlling shareholders. With the amendments, this higher standard applies only to take-privates.

If the statutory safe harbors are met, the deal "may not be the subject of equitable relief" (*e.g.*, cannot be enjoined) and will not give rise to a damages award. The clear statutory procedures also will help make the outcome of transactions more predictable for corporations and their boards, and make it less likely that stockholders will routinely file litigation over nearly every transaction that involves a controlling stockholder or control group.

Can directors still be sued over such deals?

If the safe harbor rules are followed for these types of transactions, directors, officers and controllers will not be subject to equitable relief or liable for money damages. Similarly, the new statutory terms protect controlling stockholders and control groups against liability for breaching a duty of care to other stockholders.

In the Spring 2025 *Informed Board* podcast Skadden partners discuss the amendments and the advantages more generally of incorporation in Delaware with Vice Chancellor Lori W. Will, a judge on the Delaware's Court of Chancery.

What do the amendments mean for books and records demands?

The new amendments specify a limited number of corporate books and records that can be accessed, including: the company's certificate of incorporation and bylaws, stockholder communications, minutes of board and committee meetings (and any materials provided to directors in connection with board actions), annual financial statements and certain contracts with stockholders, plus a few other enumerated categories.

The revised statute also requires that requests be made in good faith and for a proper, stated purpose.

If a stockholder can demonstrate a compelling need for the records beyond those specified, and they are for a legitimate purpose related to their investment, the stockholder can go to court and request an order granting them access, but the burden will be on the stockholder to show their need.

Among other goals, the changes are intended to streamline and reduce the expense and burden on companies of responding to books and records demands, and will likely curtail litigation over invasive demands for informal communications such as texts and emails.

Will the changes reduce litigation against companies and directors?

The expectation is that the safe harbors and the additional clarity on crucial standards and procedures will reduce the number of suits against companies, controllers and directors that have engaged in a corporate transaction or act. The safe harbors are also designed to provide greater certainty for transaction planners, and the expectation is that, if the statutory requirements are met, more cases will be dismissed at an early stage.

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Making Sure Newly Cautious Shareholders Get the Information They Want

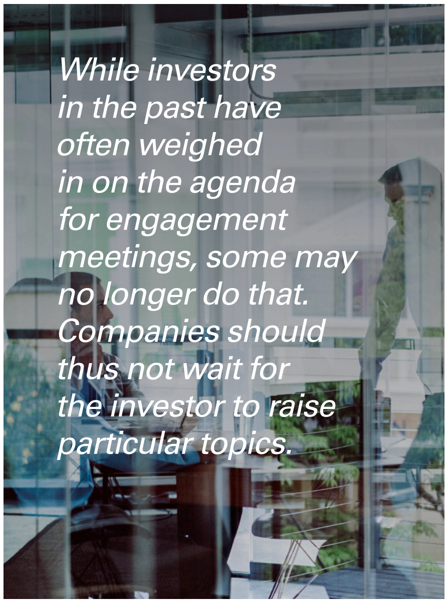
- Revised guidance from the SEC regarding ownership reporting is making institutional investors circumspect about raising issues with management.
- Seeking to influence a company's executive compensation, or its social, environmental or political policies, may disqualify a shareholder from filing short-form ownership reports.
- Companies need to respond proactively, anticipating major investors' issues and information they want but may be reluctant to ask for.

Recently updated guidance from the staff of the Securities and Exchange Commission (SEC) regarding its beneficial ownership reporting rules has had a significant impact on companies' interactions with major shareholders, making some shareholders cautious about initiating discussions on corporate policies with a company's management. Companies need to adapt their approaches to engagement to respond to changes from institutional shareholders.

Shareholders with beneficial ownership of more than 5% of a class of registered voting securities must report their holdings on either Schedule 13G or 13D. If they do not hold their securities "with the purpose of changing or influencing the control of the issuer" they can avoid filing the more detailed Schedule 13D. Instead, those passive investors may be eligible to file a simpler form, Schedule 13G. For large institutional investors with more than 5% beneficial ownership in many public companies, the ability to file on a Schedule 13G avoids significant administrative burdens.

In the past, the SEC staff had said in its guidance that engagement with management on executive compensation, environmental, social or other public interest issues, or corporate governance topics unrelated to a change of control, typically would not prevent the shareholder from reporting on Schedule 13G.

On February 11, 2025, however, the SEC staff rescinded that interpretation and said that investors may no longer be allowed to use the shorter form if they "exert[] pressure on management to implement specific measures or changes to a policy" — that such lobbying about policies may now be deemed to "be 'influencing' control over the issuer."



As examples, the SEC staff cited pressure on management "to remove its staggered board, switch to a majority voting standard in uncontested director elections, eliminate its poison pill plan, change its executive compensation practices, or undertake specific actions on a social, environmental, or political policy."

The change has made institutional investors circumspect about raising policy issues in discussions with a company's management. And, in response, companies are having to change their approach to interactions with major shareholders. Here is what we are seeing, and how companies can adapt so that their biggest shareholders get the information they want but may now be reluctant to ask for explicitly.

- **Change:** Investors are being cautious about requesting an engagement and, in many cases, may engage only when requested by companies. Among the factors that investors will likely consider when agreeing to a meeting may include the proposed date of the meeting in relation to the date of the shareholder meeting and the proposals on the agenda at the meeting. Meetings with contested agenda items will likely be greeted with particular caution.

  Response: Companies that want to speak to an investor should take the initiative to arrange the meeting.

- **Change:** In the past, investors have weighed in on the agenda for engagement meetings. Many investors may no longer do that and, if they do, any suggested agenda topics are expected to be less prescriptive.

  Response: Companies should be prepared to discuss the topics that they expect the investor will likely want to cover and not wait for the investor to raise particular topics.

- **Change:** Questions from investors at engagement meetings will likely be more open-ended and less targeted. For instance, questions are now likely to be more broadly worded. Such as: "We would appreciate if you could share your thoughts on…."

  Response: Companies should be prepared to answer the questions and add gloss that they expect the investor will want/need to make informed investment decisions.

- **Change:** Similarly, investors will likely not answer pointed questions, including and most specifically any questions about how the investor intends to vote.

  Response: Companies should be prepared to ask investors more broad-based questions, such as: "Did you get enough information to make an informed voting and/or investment decision."

– **Change:** Investors may read disclaimers at the beginning of engagement meetings. The use of these disclaimers will not necessarily eliminate the possible implications under the new SEC staff guidance. Nonetheless, investors will likely want to make it clear that they do not intend to exert pressure or take the discussion beyond what the SEC staff currently thinks is allowed for companies filing on the shorter Schedule 13G.

  Response: Companies may want to respond that they understand the plan for the discussion and they similarly do not intend for the discussion to go beyond what is required.

Many companies have significantly expanded their shareholder engagement efforts over the past few years and companies typically are well served in building productive relationships with their long-term investors, notwithstanding these changes to potential engagement meetings. To make the most of these discussions, companies need to take into consideration the new constraints institutional investors feel because of the revised guidance.

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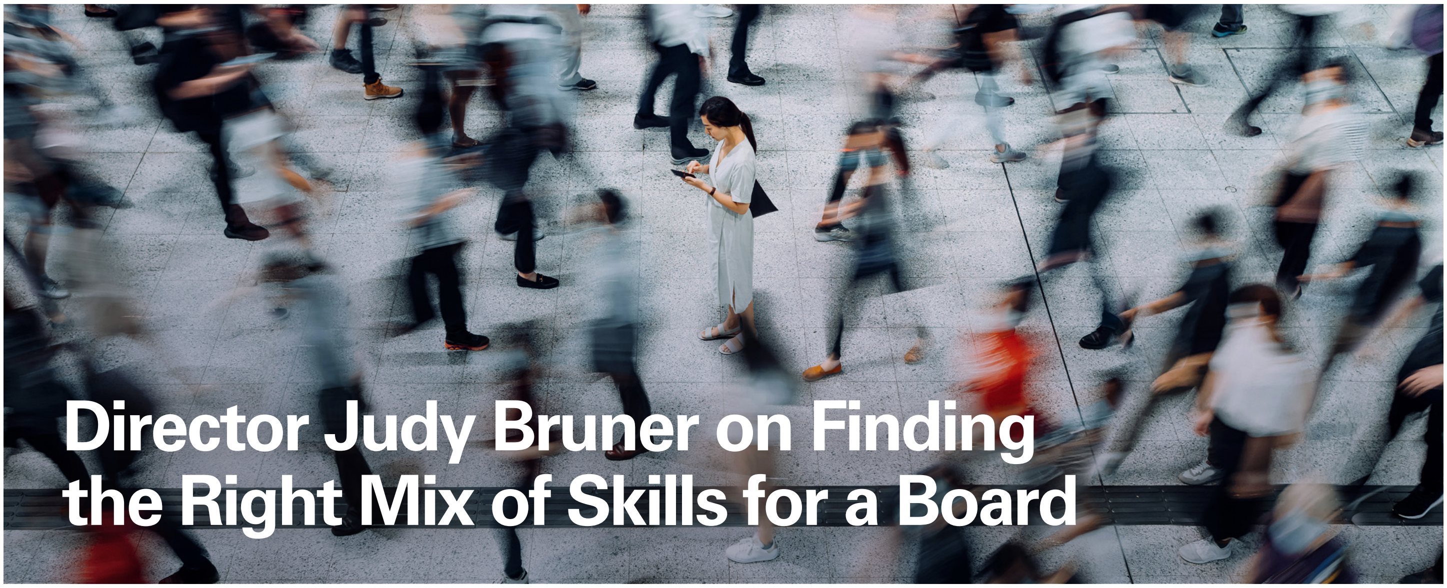


Director Judy Bruner on Finding the Right Mix of Skills for a Board

Well-run boards are constantly evaluating their own make-up, including the optimal mix of skills and experience among their directors. In an interview with *The Informed Board*, Judy Bruner discusses the ways in which a variety of backgrounds helps make a board effective. Bruner is currently a director at Applied Materials, Qorvo, Rapid7 and Seagate Technology, and previously served on the board of Varian Medical Systems and Brocade Communications. She was previously CFO of SanDisk and Palm.

How do the varied experiences and skills of other directors contribute to board discussions and decision-making?

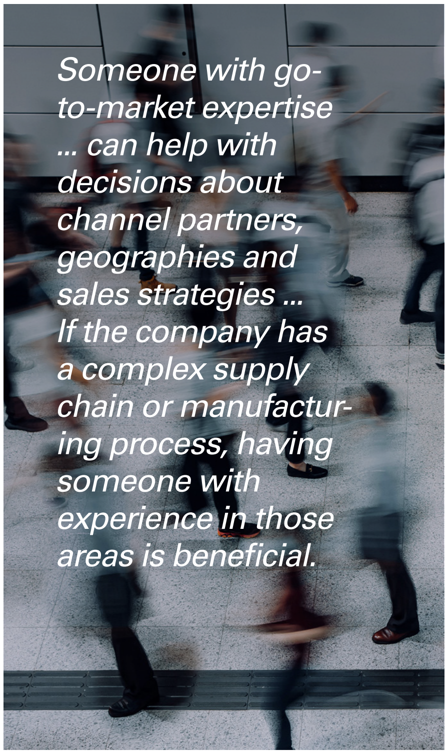
From my experience serving on boards for over 20 years, I believe it takes a mosaic of skills to be effective. At least a few members of the board should have deep experience in the industry the company operates in because they are familiar with the products, customers, suppliers and cycles of the industry. This familiarity provides valuable pattern recognition in determining both strategic and operational decisions for the company.

And what about directors from outside the industry?

Having some directors from outside the industry can be very helpful too. They ask questions that industry insiders might not think to ask, bringing a fresh perspective that can be valuable in decision-making.

What about functional expertise?

Functional expertise is also crucial. Boards often draw from CEO and CFO backgrounds, but executives from other areas can add significant value. For example, someone with go-to-market expertise, such as a former sales or service executive, can help with decisions about channel partners, geographies and sales strategies. Similarly, if the company has a complex supply chain or manufacturing process, having someone with experience in those areas is beneficial. Government expertise is becoming more valuable due to changing policies, and technology experts can help with both developing and commercializing new technologies.



How does the range of directors' experience come into play in the board's oversight role?

The most important job of the board is oversight — oversight of strategy and decisions, though not necessarily making those decisions. While functional expertise is valuable, it's crucial to have directors with C-level experience who understand governance and have dealt with investors and public markets. This experience is essential for strong governance.

There's been talk about having specific expertise like cybersecurity or climate issues on boards. What's your take on that?

While it's beneficial to have expertise in areas like cybersecurity, it's not always necessary to have someone at every board meeting. You can hire experts as needed. If you can find someone who adds strategic value to the board and also has specific knowledge such as cybersecurity, that's ideal. For example, one of my companies brought on a C-level executive with IT and cybersecurity expertise. This executive was added to the board for the strategic value they could contribute, and the IT and cybersecurity expertise made this board addition a win-win. I believe the first priority should be to identify directors who can provide broad strategic value and governance experience.

What about human resources expertise?

I haven't often seen boards specfically looking for chief human resources officer — CHRO — expertise, but human capital is always important. Most directors have dealt with a wide array of human capital issues in their roles as CEOs or other C-level executives. Compensation committees are broadening their focus to include human capital issues, and I believe this will lead to some searches focused on CHRO expertise, but so far, I see boards typically bringing in third-party experts or the company's CHRO for specific issues.

How do you screen for directors who might dominate discussions?

The best way to screen for that is through deep reference checks with people who have sat on a board with the individual, especially in the same industry. This helps ensure the person understands the collaborative nature of board work and will enhance rather than disrupt the board culture and decision-making.

Can you give an example of how different directors' experiences have shaped a debate?

Sure. In a discussion about capital allocation, a director with a Wall Street background might advocate for higher dividends and share repurchases to increase shareholder value. In contrast, a director with operating experience might be more risk-averse, having dealt with downturns and preferring to maintain liquidity and low leverage. The key is finding a balance between these perspectives. Another example is in discussing the best approach to commercializing a new product in Asia, a board member who had lived extensively in the region was able to add valuable perspective on the marketing approach and the importance of local presence.

Any final thoughts?

It's important to have a mix of industry expertise and outside perspectives on a board. This combination helps in making well-rounded decisions and provides valuable oversight.

Director Matthew Massengill Shares Firsthand Lessons About Splitting a Company

Matthew Massengill is a director and former chairman and CEO of Western Digital, which announced plans in October 2023 to spin off its flash memory businesses from the division that makes hard drives. He spoke with *The Informed Board* about the board process leading up to the decision, and the board's role in the ongoing preparations for the split, which was completed on February 24, 2025. He has served on the board since 2000, and was CEO from 2000 to 2005.

See also our Spring 2024 article "Best Practices: How a Board Can Enhance Shareholder Value Creation in a Spin-Off."

What was the process that led up to the decision to spin off WD's flash memory business?

As a board, we had been examining this and other strategic options — not just a spinoff — for at least two years, prompted by discussions with management and within the board, and with investors.

While both businesses were performing well, shareholders were not happy. Many said they would prefer to invest in a pure hard drive or a pure flash memory company. There was overwhelming evidence that we were paying a penalty in terms of our valuation for having these two businesses under one roof.

With the help of advisers, we ran financial analyses that showed the businesses could benefit from operating independently, with separate capital structures. There was also the less quantifiable factor that, as separate companies, each management could focus exclusively on their segment of the storage market.

How did you go about forming a second board for the flash memory spinco?

We made the decision at the board level that, for continuity and instiutional memory, we had to have some existing WD directors on the spinco board, selected along with new directors based on their skills to create the right mix.

We formed an assessment committee that created a matrix of the skills each business would need and we gave thought to who from our existing board would meet those criteria.

What about senior management?

Because the two businesses had operated to a large degree independently, with their own management structures, in the vast majority of cases, it was pretty obvious who would go where.

But the board did have to fill the most senior positions, such as CEO and CFO, for each half of the business. We brought in an outside consultant to help with that, and they interviewed internal and external candidates to gauge the available talent. That provided a very valuable independent perspective.

What advice would you give to directors at other companies weighing a spinoff?

First, you have to be open to the possibility that a strategy that made sense in the past doesn't now. When we agreed to buy SanDisk and its flash memory business in 2015, that technology looked like it would dominate the industry in the future. But the growth of cloud computing since then has created enormous demand for hard drives, so hard drives have remained a very vibrant business.

Second, make sure the rationale for the spinoff is solid and that that your analysis is thorough. What made our decision in some ways hard was that this wasn't the spinoff of a minor, non-core unit. The two businesses are roughly equal in revenue, and both had strong positions in their markets. What made it easier is that they have been run fairly independently, so the dividing line was relatively clear.

Finally, I'd say be prepared for the challenges of juggling all the work necessary to prepare for a spinoff while also managing the existing businesses and keeping customers and employees happy.

Listen to the podcast

Delaware is widely regarded as having the most business-friendly legal framework in the nation. Yet, a handful of companies have announced plans to reincorporate outside of the state. In our podcast, a Delaware judge and senior partner in Skadden's Wilmington, Delaware office describe the state's unique focus on corporate law, including well-developed case law, a flexible corporate code and responsive executive and legislative branches, and why reincorporation outside of the state may not be the right move for your company.

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