

The Informed Board

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With the rise of prediction markets, there is a danger that insiders may abuse their access to information for profit in new ways. Companies may need to revise their codes of conduct and other policies covering the misappropriation of information if they are limited to senior managers or trading in securities.

Also in this issue of *The Informed Board*, we address an increasingly common question from directors: Why not use AI to record and draft board minutes? (Spoiler alert: You would do so at your own risk.)

The vast sums being invested in AI development and data centers are driving deals, and not just in tech, Citigroup's Co-Head of M&A Drago Rajkovic tells us. Moreover, sellers must be prepared to show how they're taking advantage of the technology because buyers are scrutinizing the ways targets use it.

Finally, in our podcast, Jefferies Chief Market Strategist David Zervos explains why he thinks a convergence of factors — including a highly resilient economy, a favorable regulatory climate and demographic tailwinds — creates ideal conditions for companies to deploy capital. He also delves into the ways Fed policy could change under its new chairman, and the import of his predecessor remaining on the bank's board.

02 How to Stay Ahead of the Risk That Your Insiders Could Trade on Prediction Markets

12 Interview: How AI Is Driving M&A ... and Changing the Process

06 AI Drafting Board Minutes? Hold Up, Wait a Minute. It's Complicated.

14 Podcast: Market Conditions Are Ripe for Long-Term Investment, Says Jefferies Chief Market Strategist



How to Stay Ahead of the Risk That Your Insiders Could Trade on Prediction Markets

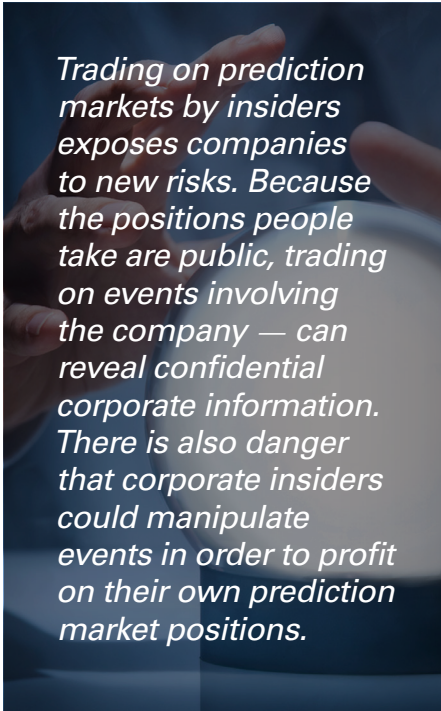
- As prediction markets have expanded, they offer corporate insiders new ways to profit improperly from nonpublic information.
- This poses several risks for companies: An insider's trades can have the effect of leaking confidential information (such as the timing of a product launch), and insiders may be tempted to manipulate corporate events to ensure an outcome that will result in a payout.
- Insiders' use of prediction markets is being closely monitored by regulators, who have pursued a number of cases, and the exchanges have moved to enforce their own rules against insiders who have improperly taken positions on prediction markets
- For their own protection, companies may need to update their codes of conduct and other policies governing confidentiality and the use of inside information so they cover the unique aspects of the event contracts traded on these markets.

Event contracts — the term for what prediction markets offer — are not new. The Commodity Futures Trading Commission (CFTC) has regulated trading of event contracts, such as weather contracts, for decades. Since 2024, when Kalshi and Polymarket began offering event contracts on election results, prediction markets have grown rapidly in popularity and the types of contracts being offered has significantly expanded. Today, major prediction market platforms offer both retail and institutional traders the opportunity to purchase contracts in a wide range of markets, including sports, culture, politics, crypto, economics and finance.

In the past, investors who wanted to trade based on expectations about the success or failure of a company were generally limited to transactions in the securities markets. Prediction markets present a new means for

traders to take positions on how both public and private companies will perform, but in a much more granular fashion than they could via securities. For example, traders can currently buy event contracts on when OpenAI will announce an IPO, whether GameStop will acquire eBay, if the Food and Drug Administration will approve a new breast cancer drug, how many spacecraft SpaceX will launch in June and whether Costco will say "hot dog" on its next earnings call.

These new markets also present new ways for corporate insiders to trade on company information improperly. Boards may need to reconsider policies that address the use of prediction markets by directors and employees. And, if the company intends to use prediction markets as a vehicle to hedge its own risks, it will need policies governing the trading of derivatives.



Trading on prediction markets by insiders exposes companies to new risks. Because the positions people take are public, trading on events involving the company — can reveal confidential corporate information. There is also danger that corporate insiders could manipulate events in order to profit on their own prediction market positions.

Background on Prediction Markets

An event contract is a type of derivative contract — specifically, a binary option — where the payout is based on the occurrence, nonoccurrence or extent of occurrence of a specific event. Depending on the underlying event, an event contract is either a swap regulated by the CFTC or a security-based swap regulated by the Securities and Exchange Commission (SEC). Currently, all event contracts traded on U.S.-regulated exchanges fall under the Commodity Exchange Act’s definition of a “swap.” However, in the future, exchanges may begin to offer SEC-regulated event contracts, or a different administration could take a different view of the classification of these novel instruments and deem some prediction market trades to be securities.

The Risk to Companies Isn’t Limited to Information That Could Affect a Stock Price

The numerous types of contracts that are available on prediction markets present new opportunities for misuse of corporate information.

Insider trading in the securities market has historically been associated primarily with high-level executives and officers who have information on major corporate events likely to have an effect on their own company’s stock price. Prediction markets, however, create new opportunities for employees, including lower-level employees, to use nonpublic information. For example, the CFTC and

Department of Justice (DOJ) recently announced charges against a Google software engineer who allegedly traded event contracts on who would be the most frequently searched person on Google in 2025 while he had confidential information about the search result trends.

The information that the software engineer had would have no effect Google’s stock price, but because prediction markets offered trading on Google’s search results, the software engineer could profit from this information.

Insiders’ use of these markets presents two new risks to companies.

Leaks. First, because trading data is public, trading on inside information in markets could lead to important corporate information leaking out. There has already been much speculation that this has occurred in reality TV markets, such as “Survivor,” when a market consensus forms around a particular candidate before the show goes on air. Whether this was due to the misuse of corporate information or rumors, a public perception that the result is already known could reduce viewer interest in the show and the live finale.

This risk isn’t limited to reality TV shows. A corporate insider could, for example, trade on the expected release date for a new mobile phone with advanced features, in the process potentially revealing the launch date and ruining a carefully planned advertising campaign.

Even if no nonpublic information has in fact leaked through prediction markets, management could face questions about whether trading on key financial inputs that could affect upcoming earning reports reflects inside information.

Manipulation of events. There is also the risk that insiders will manipulate events in order to profit on their own prediction market trading. A high risk area is contracts where the outcome is controlled by a single person or small group at the company. For example, where payouts are based on whether certain words are spoken on an earning call, a rogue officer could take advantage of those markets to trade on words that he intends to say, or not say, during the call. Or a lower-level employee involved in drafting remarks for the earnings call could plant words in the script.

Event Contract Trading Is Being Monitored by Enforcement Officials

Boards that are concerned about insiders revealing corporate information by trading on prediction markets should be aware that U.S. regulators, including the exchanges themselves, have made this a significant area of focus. CFTC Director of Enforcement David Miller has repeatedly emphasized in public speeches that enforcing insider trading laws with regard to prediction markets is a top priority for the agency. Jay Clayton, the U.S. Attorney for the Southern District of New York, has said that he anticipates his office will bring cases based on improper insider use of corporate information on

prediction markets. And Kalshi, a popular prediction market platform, has already announced a number of enforcement cases against individuals who have traded while in possession of material nonpublic information on its exchange.

Preventing Abuses May Hinge on the Wording of Company Policies

Companies should be sure there are no loopholes in their policies governing confidentiality and the use of inside information that could allow the misuse of that information on prediction markets.

Insider trading in the commodities market on corporate information is prohibited under the Commodity Exchange Act, as well as the criminal wire and mail fraud statutes, only if the trading occurs in breach of a duty to the source of the information. In alleging a breach of a duty, the DOJ and CFTC are likely to point to corporate policies outlining insiders' duties.

If a company's insider trading policies are limited to securities transactions, or if only high-level employees are required to sign nondisclosure agreements, these policies may be insufficient to create the duty required by insider trading statutes. In order to eliminate these gaps, companies should review their codes of conduct, and nondisclosure and other relevant policies, to assess whether they encompass trading in these new instruments. Companies should consider which policies are most appropriate to cover trading

on prediction markets, and that they apply to all employees, and third party vendors, who may be in a position to trade on company information.

Exchange Rules Could Apply to Companies Planning to Use Prediction Markets to Hedge Risks

If a company intends to use prediction markets to hedge its own risks, there will be other issues for its board to consider.

To date, prediction markets have seen more popularity with retail traders, in part because the contracts must be fully collateralized. However, many prediction markets are beginning to offer trading on margin, as well as block trading, which increases their usefulness as a means to hedge corporate risks.

While the Commodities Exchange Act's prohibition on insider trading does not restrict the ability to trade on one's own inside information (e.g., a company trading on its own nonpublic information), many prediction markets have adopted rules that do prohibit this type of insider trading. Companies that plan to use prediction markets as a means to hedge should therefore review the rules of the exchanges that they plan to utilize and ensure that their trading is consistent with those rules.

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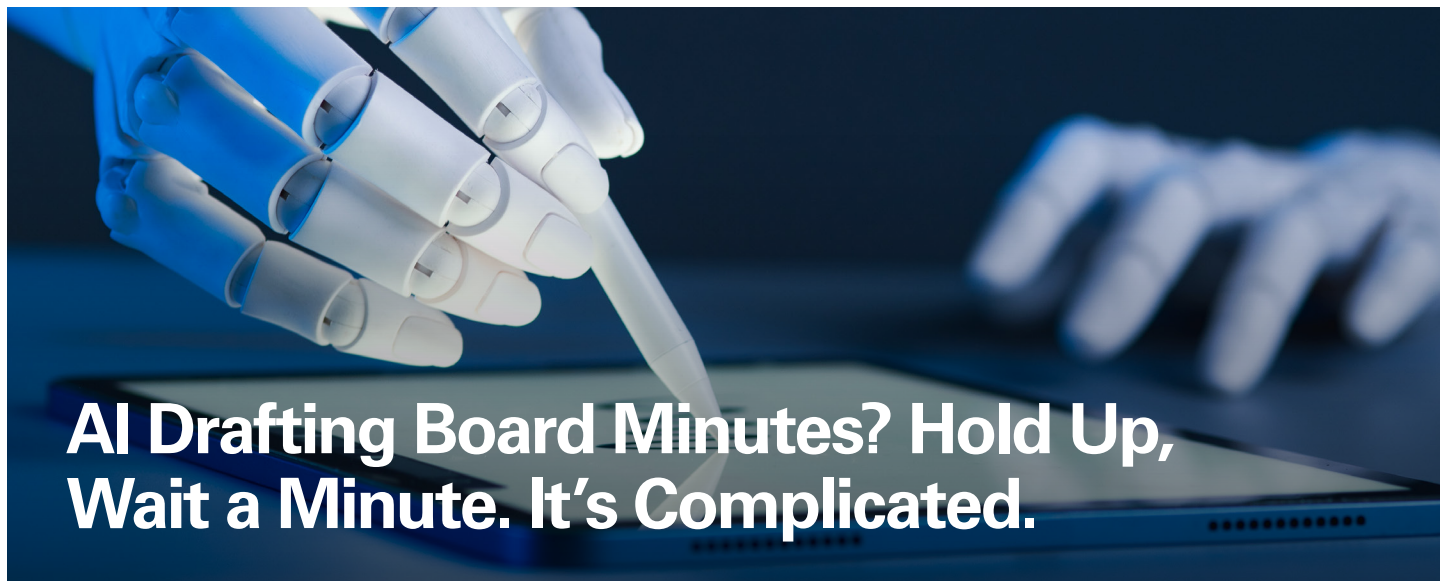
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AI Drafting Board Minutes? Hold Up, Wait a Minute. It's Complicated.

- Using artificial intelligence tools to record or transcribe board meetings, or generate minutes, can create detailed records of confidential discussions that could create problems if they have to be turned over in litigation.
- In addition to the issues with minutes, other uses of AI by directors can pose legal problems. For instance, communications between directors and AI tools are generally not protected by attorney-client privilege, and AI-assisted materials may not qualify for work product protection — meaning candid exchanges with a chatbot, as well as AI-generated drafts, may be discoverable in litigation.
- AI-generated materials should be treated like any other records and should be preserved when litigation becomes likely.

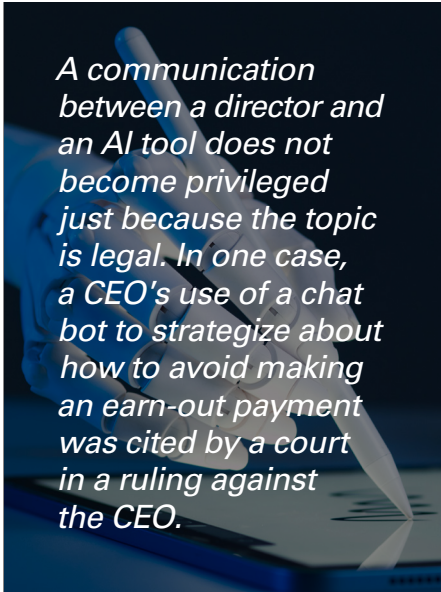
Artificial intelligence (AI) tools for board-related work have matured quickly. AI can comb through prior minutes on similar topics, summarize lengthy materials ahead of meetings, and even transcribe meetings in real time and generate draft minutes. All of these things can save time for directors and allow them to focus on certain issues at board meetings.

But the convenience comes with potential pitfalls, and directors need to be alert to them. The stakes are particularly high for AI-generated board minutes, because minutes can turn candid boardroom discussions into a lasting governance record. Many of the same issues also apply more broadly to other uses of AI in the boardroom and in corporate governance.

Using AI to Record and Draft Minutes Is Risky and Could Deter Open Discussion

With all the attention paid to AI at present, directors sometimes ask if AI could be used to compile board minutes or other records. They could, but it would be risky.

Board meetings often cover business updates, strategic planning and legal matters. Directors may speak frankly during those discussions, and disagree, and many of their comments are intentionally omitted from formal minutes. AI-generated transcripts and minutes can capture far more detail than traditional minutes, including unnecessary information, and do not accurately reflect inflections that signal sarcasm or jokes.



A communication between a director and an AI tool does not become privileged just because the topic is legal. In one case, a CEO's use of a chat bot to strategize about how to avoid making an earn-out payment was cited by a court in a ruling against the CEO.

Such recordings can potentially chill open director discussion. In addition, AI-produced summaries can contain errors or misleading characterizations.

Another risk to bear in mind is that recordings, transcripts and AI-produced draft minutes would likely need to be turned over to adversaries in litigation, potentially exposing candid, confidential exchanges among directors. This risk is illustrated by the cases discussed below.

AI Communications Are Not Privileged and Are Discoverable

Courts are already being asked to address the issue of discoverability.

Attorney-client privilege generally protects confidential communications between a client and a lawyer made to seek or provide legal advice. But chatbots are not lawyers. A communication between a director and an AI tool does not become privileged just because the topic is legal, the information is sensitive or the vendor agrees to keep it confidential.

Recent court decisions highlight the discoverability risk of AI interactions. A federal court in New York held that an executive's exchanges with a public generative AI platform were not protected by attorney-client privilege. The reason was simple: The platform was not the executive's lawyer, its data practices did not support a reasonable expectation of confidentiality and the communications were not made to get legal advice from counsel.

In a Delaware case this year, a CEO's interactions with a chatbot proved to be crucial in a ruling against him. The court quoted from the CEO's AI chatbot conversations where he asked for help devising a strategy to avoid making a potential \$250 million earnout payment. The court used those exchanges as evidence of the CEO's motive, and also noted that some AI logs had been deleted.

The takeaway: AI interactions are not off-the-record brainstorming, and the same is true of AI-generated draft minutes. They will likely become part of a case and a court may focus on them if it thinks they reflect a director's or executive's most candid thoughts.

It's Unclear if Work Product Protection Is Available

The work product doctrine protects materials prepared in anticipation of litigation from being disclosed to an adversary. Courts are still deciding how that doctrine applies to AI-assisted materials, and the early answers are inconsistent.

In the New York case above, the court concluded that AI-created documents were not protected work product. Even if they were prepared in anticipation of litigation, they were not prepared by counsel or at counsel's direction, as the doctrine requires.

A federal court ruling in Michigan reached a different result. It held that a *pro se* litigant's AI-assisted drafting materials were protected as work product and the court held that using

ChatGPT did not waive the protection, because waiver usually requires disclosure to an adversary or disclosure that is likely to put the material in an adversary's hands. However, this case involved a litigant representing himself without lawyers.

We should point out that the work product doctrine may not apply to ordinary minute-taking. Even when the board meets to discuss pending or threatened litigation, work product protection may not apply if the minutes were not prepared by counsel or at counsel's direction. (Under Delaware law, drafts of minutes prepared by lawyers are privileged.)

Litigation Holds Can Apply to AI-Generated Content

When litigation is anticipated, directors and other and others at the company have a duty to preserve records that could be relevant in the dispute. That includes AI-generated minutes, transcripts, summaries and other content, which should be preserved if litigation is clearly on the horizon. Routine deletion of AI transcripts may be defensible in normal circumstances and may even be good information hygiene. But once a duty to preserve applies, if records are deleted, that could open up a company and its board to accusations of spoliation of evidence. A company's retention policy should address AI-generated materials and explain when preservation obligations override routine deletion.

Use AI Thoughtfully – Don't Avoid It

None of this means boards should avoid AI tools. The technology can save meaningful time and the legal issues can be managed with the right approach. Boards should consult with counsel before adopting these tools and should put practical guardrails in place. Those guardrails may include:

- Deciding whether or not to transcribe meetings or parts of meetings.
- Using AI tools in ways that protect privilege and work product where possible.
- Setting clear procedures for review, approval, retention and deletion of AI-generated records.

Directors should approach AI the same way they approach other governance tools: Ask the right questions, get counsel's input and make informed choices. Used carefully, these tools can support and enhance director's work.

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Interview: **How AI Is Driving M&A ... and Changing the Process**

Economic and political factors are major drivers of the uptick in mergers this year, says **Drago Rajkovic**, Citigroup's Co-Head of M&A. But it's also hard to underestimate the effect of artificial intelligence (AI), as the impact of the billions of dollars flowing into AI developers spreads across the economy.

The disruptive potential of the technology is being felt not just in software, but in sectors far removed from tech, where the impact of AI is providing a rationale for deals.

AI is also reshaping the merger process, from how companies prepare for a sale to how acquirers approach due diligence.

There has been an upsurge in M&A activity this year, particularly large deals. What's behind that?

The economic outlook is very positive — we have record earnings, stimulative fiscal policy and deregulation. And we have these massive AI investments flowing throughout the economy. Plus, midterm elections are approaching, which often are preceded by economic stimuli by the governing party.

Interest rates are still not punitive and capital is widely available. Inflation is still contained, even though it has increased with the war and as the impact of tariffs is gradually felt.

It's been a great earnings season, exceeding expectations by a margin not seen for some time. Share prices are at record levels, and there's a lot of confidence in boardrooms.

In addition, there has been regulatory permissiveness. Current thinking is you have about a year-and-a-half to do something bold. If you don't get it signed in that time, you could face a new administration before closing and you don't know whether regulators may take a different approach.

How big a factor is AI in all this?

AI is driving consolidation and scaling across industries — power, industrials, services and tech, of course. Nobody in this market wants to miss this opportunity. And the hyperscalers will continue to invest a lot of money.

We're also beginning to see AI deals outside of tech. We advised General Catalyst in its purchase, along with Trian, of Janus-Henderson, the asset manager. The idea is basically to AI the entire business, from portfolio management to customer relations. General Catalyst and Long Lake



AI is driving consolidation and scaling across industries — power, industrials, services and tech, of course.... There are reports that Jeff Bezos plans to raise a \$100 billion investment fund to transform businesses across industries with AI.

– Drago Rajkovic,
Citigroup’s co-head of M&A

Management are also buying American Express Global Business Travel Group with the same aim.

There are reports that Jeff Bezos plans to raise a \$100 billion investment fund to transform businesses across industries with AI.

How does AI play into the merger process itself — prepping for a sale and doing diligence on the buy side?

In every sell-side deal, we go very deep into what the company’s AI strategy is, and their defensive moat. We spend a lot of time helping companies with this both as they prepare for sale and when they look to buy.

We read a lot about AI’s threat to the software industry. How does that shape this market?

Tech M&A is about 25% of M&A activity, but tech M&A this year is down by about half. Most of that drop is in software, which is about 50% of tech M&A.

The risk of AI to the SaaS [software as a service] business model and the software value proposition has resulted in a large sell-off in software stocks. There’s a broad sense that software is oversold, but also a consensus that there’s not going to be a big rebound as investors wait to see the durability of those business models.

Because of recent valuations down rating, we’re seeing big software companies finding that target companies are reluctant to consider a sale. I’m also getting calls from financial sponsors asking if I know anyone willing to talk to them. So there’s money there for acquisitions, but it’s hard to get engagement and agreement between buyers and sellers on price.

However, on the semiconductor side, the market is vibrant, with some of the beneficiaries of AI looking to deploy capital.

We’ve seen some large spin-offs recently in tech. Do you expect more of those?

Yes, we advised Flex, an outsourced manufacturer, which announced the spinoff of its high-growth data center and digital infrastructure unit. Its share price appreciated about 50% within days. We’ll see more of these. And then some of the big tech companies want to refocus, so we’ll also see the sale of business units to raise capital.

How big a factor are sponsors in this market?

Sponsor activity has continued to be vibrant outside tech. The activity is significantly higher than last year with a lot of capital deployed. However, banks are becoming nervous about lending into deals that are exposed to AI. That’s a bit of sand in the wheels of the software sector at this point in time.

How do you view the regulatory environment, including in Europe and China?

For China to shut down a deal, it has to be very strategic for them. We haven't seen a lot of trouble with clearances there. It's mostly semiconductors where there are issues, and deals that bring semiconductor technology within U.S. control.

The European agencies are being very politically aware, not wanting to provoke the U.S. For a U.S. company, that makes things easier. There is more protectionism in Europe today, but we haven't seen that play out in M&A situations extensively yet.



**Listen to
the podcast**

Rising productivity, a growing capital share of GDP, a favorable regulatory environment and strong demographic tailwinds are converging to make this an extraordinary time for businesses to deploy capital, says David Zervos, chief market strategist at Jefferies, in the latest Informed Board podcast.

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