Skadden

The Informed Board

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Short sellers make their money by publishing information that attacks a company in order to drive down its share price. How can a company prepare? And what should it *not* do in the face of a short attack? We offer some tips in the latest issue of *The Informed Board*. We also provide guidance to directors deciding whether and how to launch an internal investigation of alleged wrongdoing.

On the regulatory front, we explain what new U.S. merger guidelines mean for companies pursuing deals, and the litigation exposure that multinationals could face when the EU's new ESG disclosure mandates come into effect. Our latest podcast covers another new EU law on government subsidies that could complicate acquisitions of companies with substantial operations in Europe. And for companies weighing whether to delist or deregister their shares, we flag some downsides that may not be obvious.

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How To Guard Against a Short Attack, and How To Respond if Faced With One

- To prepare for the possibility of a short seller attack, companies should assess their vulnerabilities, maintain open channels of communication with shareholders, monitor short positions and changes in their shareholder base, and formulate a communications strategy.
- In the face of a short attack, it is vital for a company to respond promptly with detailed evidence to rebut the short seller's accusations point by point.
- Share buybacks and dividend increases may help to restore a share price depressed by a short attack, but there is a risk that these may be seen as superficial defensive moves that do not address fundamental questions about the business.
- Suing the firm or individuals behind a short attack or seeking an intervention by regulators rarely is successful and can backfire, drawing attention to the criticisms.

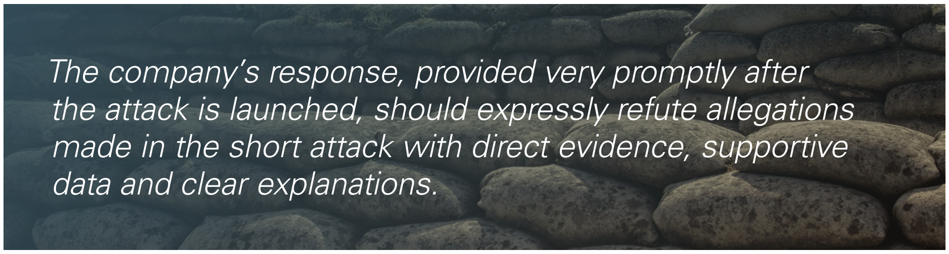
The Nature of Short Selling Attacks and Short Reports

Short selling attacks create unique challenges for boards, management teams and companies. Unlike traditional long activists, whose ultimate goal is to enhance shareholder value, short activists aim to destroy value. Their goal is to capitalize on a drop in the target company's stock price caused by releasing research purporting to identify unfavorable information about the business. The release is typically coupled with a carefully orchestrated media and social media campaign to undermine the financial position and reputation of the company. After depressing the share price, the short activist can acquire shares to cover its short position below the price at which it sold and turn a profit.

Activist short sellers view themselves as investigators, engaging in deep research, eliciting information from insiders and performing physical detective work, to "unearth" material that suggests the company is overvalued. Their reports may claim to expose reporting and accounting issues, undisclosed material information or affiliate transactions, or misconduct by management, among other things.

Short attacks present a clear and present danger for boards by creating uncertainty, negatively impacting investor perceptions of management, the board and the company, and diverting executive and board attention.

Responding efficiently and effectively to a short attack is mission critical for boards to protect shareholder value. It requires foresight to identify potential attack vectors, and advanced preparation so that a company is well positioned to respond effectively on short notice. Here we provide tips on how to prepare for and respond to such attacks, as well as pitfalls to avoid.



> *The company's response, provided very promptly after the attack is launched, should expressly refute allegations made in the short attack with direct evidence, supportive data and clear explanations.*

Understanding Vulnerabilities and Preparing in Advance for Short Attacks

Boards are keen to understand and identify the factors that may invite a short attack, and indicators that an attack is on the horizon.

Potential vulnerabilities may include rapid or unexpected turnover at the executive level; regulatory scrutiny or investigations; industry-wide vulnerability or a recent history of short/long activist attacks at competitors; indications of improper financial reporting or internal controls; and, perceived or real, poor operating performance or poor execution of the strategic plan.

Advanced preparation by the board, with support from management and outside advisors, is key. Boards and management teams should:

- Conduct risk and vulnerability assessments to identify potential attack vectors for short activists.
- Track industry and market trends and sentiments to ensure that management has an accurate understanding of the current landscape and how that may affect the company.
- Monitor accumulations of short positions and keep a keen eye on traditional and non-traditional investor platforms.
- Remain attuned to the conversation in the market around the business.
- Understand investors' views of performance, strategy and governance to help build value and respond to any investor concerns.
- Develop a robust communication strategy to articulate the company's short- and long-term strategic plans, highlighting progress toward goals through steady, coordinated news flow and disclosure in advance of any short seller's campaign — measures that will help undermine the credibility of a short attack if there is one.

Key Considerations When Responding to a Short Attack

By employing a thorough and proactive approach, companies can protect their credibility and even reinforce investor confidence. Here are ways to respond when faced with a short attack:

Research and Profile the Short Activist

While a short seller's objective is clear, boards and management teams should research the short seller's current and past campaigns to identify patterns of practice, particularly in scenarios where there is advance warning that an attack is on the horizon. In short campaigns, information is gold and a better understanding of the short activist and its playbook will aid in the company's defense.

Communication and Engagement Is Key

Communication is paramount, and companies will need to rapidly execute an investor outreach program.

As an initial matter, it is important to understand whether the short campaign has gained traction with the company's investor base. Communicating extensively with large shareholders and research analysts is crucial throughout the campaign to guide the response.

Depending on the circumstances, the company will likely need to fashion a timely and transparent response to address the issues raised in the attack. This generally will be in the form of a press release, media statement and Securities and Exchange Commission (SEC) filing, ideally very promptly (*i.e.*, within 24 hours) after the onset of the attack. It may be wise to hire an experienced crisis public relations firm.

The response should expressly refute allegations made in the short attack with direct evidence, supportive data and clear explanations. Categorical, high-level denials, without factual back up, coupled with only an attack on the short-seller itself, is typically ineffective. Methodically addressing each point raised by the short seller shows investors that the company's management has considered the concerns raised and has, where appropriate, taken proactive action to address those.

Financial Responses

To counter the impact of a short attack on a company's share price and alleviate shareholder concerns, a board may consider share buybacks or increased dividends. However, while these strategies may be intended to show the board's and management's faith in the strategic plan and underlying strength of the business, there are risks associated with these responses.

While share buybacks offer short-term price support, they do not provide a long-term solution to fundamental concerns raised by the short activist and may be portrayed as a pure defensive measure that further amplifes the criticism.

Similarly, while raising dividends may convey confidence and a commitment to returning capital to shareholders, they may also limit a company's flexibility to make future investments, and they likely fail to address the core issues raised by short sellers. Thus, this strategy, too, could be portrayed as a form of mismanagement or poor decision-making by management and the board.

Potential Pitfalls To Avoid

Just as careful preparation and a sound response strategy are crucial, it is important for boards to understand what *not* to do in the face of a short attack.

Do Not Expect To Engage With the Short Activist

There is rarely any point to engaging with a short activist. Unlike traditional long activism campaigns, where the goal is to cause the company to take action to increase shareholder value, the short activist's sole goal is to destroy shareholder value. Consequently, the short activist is not interested in coordinating with or engaging with management to do what is in the best interests of shareholders. These investors have a thesis and generally are unconcerned with the company's contrary position. Therefore precious time and resources should not be expended attempting to sway short activists to change their positions. Instead, energy should be directed to making the company's case to the broader investor community.

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Do Not Ignore the Attack or Leave It to Shareholders To Sort Out the Truth

In general, it is not in the company's best interests to completely ignore a short attack. Companies should not rely on the investor community to identify how a short activist's claims are incorrect or misleading. Failing to address a short seller report or campaign publicly may increase investor uncertainty and lead investors to assume the truth of the short seller's claims. The onus is on the company to disprove these claims.

Responses should be well-articulated and, although time is of the essence, they should not be impulsive: They should be focused on addressing the substantive criticisms and allegations and not on the activist or its motivations. Any personal attacks or aggressive language toward the short seller are counterproductive and may be viewed as unprofessional and unbecoming of the company's leadership, lending support to the short campaign.

In rare circumstances, if there has been no notable impact on the company's stock price and if the campaign has not gained traction with the company's investor base or the media, a company may consider not responding. In such instances, responding could simply put the spotlight on the short seller's allegations.

Even if the board deems that a public response is unwarranted, the short campaign should be carefully tracked, and the company should remain prepared to respond if circumstances change.

Think Twice Before Pursuing Legal Action or Regulatory Intervention

In most cases, suing short sellers is not an effective response strategy, even though there will often be an understandable desire to bring claims for defamation, stock manipulation or other unlawful practices. In practice, these lawsuits are costly, time-consuming, add to the uncertainty surrounding the stock and, in light of the evidentiary burdens, are rarely successful. Moreover, the discovery process may require the company to unveil sensitive information, and litigation may attract additional media attention to the short seller's accusations.

The same drawbacks apply to efforts to obtain regulatory intervention, for instance, by alerting regulators such as the SEC of inappropriate conduct such as market manipulation. In practice, such efforts generally are not productive, and may in fact lead to additional regulatory scrutiny or investigation of the company, potentially distracting the board and management and playing into the short seller's hands.

The Bottom Line

Success against a short attack is most likely to result from a carefully crafted response to the substantive issues presented in the campaign and not from time- and resource-consuming litigation, regulatory intervention or other actions that do not address the substance of the attack.

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Ten Key Factors for Boards To Consider When Weighing an Internal Investigation

- When a complaint reaches a company's board, directors need to assess how serious and detailed it is, and how credible it is at first glance, before deciding how to investigate it.
- If similar complaints have been lodged in the past, that could suggest systemic problems and greater risk for the company.
- An investigation will take on added urgency if the regulators or external auditors are aware of the allegations, or if those may affect pending financial or strategic transactions.
- Other complicating factors: any allegations against management, conduct the company has a duty to report and the potential for financial restatements.

Suppose you are a member of an audit committee and learn about a whistleblower complaint alleging wrongdoing at the company. Maybe it's just an aggrieved former employee, and it has no merit. Maybe you should direct the company to investigate. That would likely save time and money. But what if it's not something so benign? The inherent risks of potential litigation, regulatory action, conflicts of interest, a perceived lack of independence and the possibility of incomplete findings loom large.

In an age when transparency, accountability and corporate governance have taken center stage, deciding when to conduct an internal investigation and who should lead it is becoming more and more important. Striking the right balance between efficiency and trustworthiness becomes critical.

There is no one-size-fits-all solution. And an audit committee may not be presented with every complaint that warrants some sort of investigation. But, for the complaints that do make their way up to the board level, below is a checklist of issues that an audit committee should consider, at a minimum, when deciding both when to investigate and the form it should take. No single factor is dispositive, but if an audit committee finds itself answering most of the questions posed below in the affirmative, it should strongly consider conducting an investigation itself with help from outside expertise (*e.g.*, forensic auditors, outside counsel).

Assess the Nature of the Allegations

Seriousness: How serious are the allegations? Could they amount to a criminal offense, breach a regulatory standard, or pose a significant risk to the company's reputation?

If the allegations suggest possible criminal activity or regulatory breaches, the stakes become considerably higher, necessitating a thorough and possibly urgent investigation conducted by outside counsel and other experienced professionals. Even if the claims are not substantiated, the potential for reputational damage can be just as consequential, affecting stakeholders' trust, stock prices and the organization's overall standing in its industry.

Outside counsel is often retained in cases that appear serious. By employing outside lawyers, written and oral reports can be protected by attorney-client privilege or the work product doctrine, which may not always protect documents created internally.

Directors should consider the advantages of truly independent advisers, without close ties to the management involved, and whether the executive should be offered his or her own counsel. If experts such as forensic accountants are necessary, they should be hired by counsel to keep their work within the attorney-client privilege.

Depth: Are these allegations detailed, specific charges? Based on the details provided, do the allegations seem credible or verifiable at first glance?

While detailed and specific allegations are more likely to seem credible and can provide a clearer path for verification, it is crucial to recognize that vagueness in a complaint does not inherently undercut its validity. In some cases, whistleblowers may provide limited information out of fear or lack of complete understanding, but their concerns can still be rooted in very real issues. That said, vague allegations might require a different investigative strategy since they may be nearly impossible to investigate.

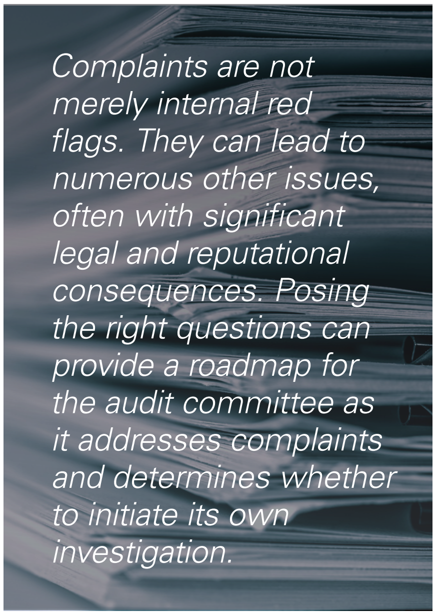
Recurring issues: Have these, or similar allegations been raised before? Were those allegations substantiated?

If other allegations of the same type have been received before, that suggests systemic issues within a company, requiring close scrutiny. Ignoring recurring concerns can exacerbate underlying problems and increase the company's risk exposure.

External Involvement and Impacts

Regulators: Has the individual reporting the issue already taken their concerns to regulators?

If the allegations have been reported to regulators, that escalates the urgency for a robust internal response because an external investigation or subpoena might be imminent. This could catch the company off guard if it is not adequately prepared. The audit committee should consider which regulators have been contacted and what their response may be. In our experience, once it is determined that regulators have been told about the complaint, proactively reaching out to them can make dealings with them more collaborative and less adversarial.



> *Complaints are not merely internal red flags. They can lead to numerous other issues, often with significant legal and reputational consequences. Posing the right questions can provide a roadmap for the audit committee as it addresses complaints and determines whether to initiate its own investigation.*

External auditors: Have the company's external auditors been alerted about the allegations? Have they provided any negative or critical feedback, or preliminary findings?

Like a complaint to regulators, an external auditor's knowledge of a complaint escalates the need for a thorough internal response. We have seen external auditors refuse to sign off on financial statements pending the outcome of an investigation. Addressing the issue with your auditor is particularly pressing when the allegations are raised close to the end of a quarter or fiscal year.

Ripple effects on corporate activities: Could the allegations or the subsequent investigation affect ongoing or upcoming corporate activities, like bond offerings or stock repurchases? Are there any immediate transactions or disclosures that need to be reconsidered or postponed given these claims? Will the company need to communicate these changes or delays, if at all, to external parties or stakeholders?

Allegations and investigations can ripple across various facets of a company's operations, so it is crucial to evaluate any financial implications and the broader effect on business continuity. For example, a complaint reported to regulators, especially if it relates to financial misrepresentation or other serious matters, may prompt an investigation, which, in turn, could delay any major financial undertakings until the issue is resolved or clarified. The complaint may also need to be disclosed during an ongoing strategic transaction. That can result in additional due diligence by the counterparty to ensure that all pertinent information is disclosed. This process can be time-consuming, leading to potential delays, and in some cases, to a breakdown of negotiations.

Internal Implications and Governance

Senior management or board involvement: Is senior management or the board implicated in these allegations? Would these allegations impact the functioning and decision-making of the company's leadership in the near term even if their conduct was above reproach? Would there be damage to stakeholder trust or the company's public image if the allegations become public?

Allegations targeting senior management or board members are particularly sensitive. Such claims, if not addressed swiftly, can undermine the trust of stakeholders, jeopardize leadership continuity, and raise questions about governance integrity. In our experience, while no one item on this list is dispositive, should the allegations touch upon individuals in the C-suite or even the board itself, an audit committee should strongly consider taking control of the investigation. And depending on the allegations, the board or some members might also have to contemplate recusal or even the formation of a special committee to ensure the investigation has integrity and to avoid a potential conflict of interest.

Duty to report: Are there clear regulatory mandates that require the company to disclose such allegations to investors or regulators, either immediately or after an internal review? Would these disclosures, if needed, negatively affect the company's relationship with investors and other stakeholders?

Disclosing allegations can impact stakeholders. Investor trust can be shaken by even a hint of potential misconduct. An audit committee may want to direct an investigation that will eventually need to be disclosed to ensure the probe is conducted independently and transparently.

Potential for financial restatement: Are there specific financial irregularities or discrepancies that are being alleged in the complaint? Assuming the allegations are true, are the alleged discrepancies significant in relation to the overall financial statements — *i.e.*, material?

If the complaint pertains to financial irregularities, companies might need to restate their financials, which can undermine investor confidence and lead to regulatory scrutiny, other potential legal consequences and reputational damage.

Other Legal Risks and Repercussions

Litigation risk: Is there potential exposure to lawsuits if these allegations are verified or if the investigation's findings become public knowledge? Is there any existing litigation or legal considerations that might be affected or complicated by these new allegations?

Litigation over the allegations not only has potential financial repercussions; it may entail reputational damage and the diversion of resources to manage litigation. The allegations may lead to direct legal actions against the company, especially if there is evidence of wrongdoing. That could take the form of civil lawsuits, regulatory actions or even criminal proceedings. If the complaint suggests widespread harm outside the company, it might give rise to class actions. Should the complaint indicate that the company's leadership acted against shareholders' best interests, the company may face a shareholder derivative suit. And depending on the allegations and the nature of any ongoing litigation, the original complaint could be discoverable.

* * *

Complaints are not merely internal red flags. They can lead to numerous other issues, often with significant legal and reputational consequences. Posing the right questions can provide a roadmap for the audit committee as it addresses complaints and determines whether to initiate its own investigation. A proactive, introspective and consistent approach will best promote regulatory compliance and protect a company's broader interests.

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What the New Federal Merger Guidelines Mean for Companies Pursuing Deals

- Proposed revisions to the DOJ's and FTC's merger guidelines would lower the threshold at which deals are considered presumptively anticompetitive, potentially increasing the number of deals regulators will challenge or subject to in-depth scrutiny.

- The new guidelines would support challenges to deals that would not raise concerns under established antitrust precedent.

- The DOJ and FTC have lost all but one of the court cases where they have sought to block mergers based on the approach in the guidelines, but the decision to issue the new guidelines signals that the agencies will continue to vigorously contest many mergers in novel ways.

In July, the Federal Trade Commission (FTC) and Antitrust Division of the Department of Justice (DOJ) released a draft of proposed new merger guidelines, 18 months after FTC Chair Lina Khan and Assistant Attorney General Jonathan Kanter announced plans to "modernize" the agencies' approach to merger enforcement.

While the new guidelines are not surprising to antitrust specialists — they formalize an approach that has been pressed from the outset of the Biden administration — in important ways they constitute a stark departure from the agencies' approach to antitrust enforcement over the past 40 years. They also make it clear that under this administration the agencies will continue to take an aggressive approach to merger reviews, despite losing all but one of their merger challenges to date.

Two aspects of the new guidelines mark particularly sharp changes from past practices, and should be understood by companies when considering transactions.

Mergers Would Be Treated as Presumptively Anticompetitive at Lower Thresholds

The new guidelines would revise accepted economic measures of competitive impact, substantially lowering the economic thresholds at which the agencies would deem a merger to be presumptively anticompetitive. The likely result: More mergers may be challenged than in the past, or at least subjected to extended scrutiny.

- Two key thresholds of market concentration used in evaluating the impact of a proposed combination would be lowered:

> *A firm could be charged with violating the Clayton Act if it engages in an "anticompetitive pattern" of multiple small acquisitions, even if no individual acquisition would violate the antitrust laws.*

a technical measure of overall post-merger market concentration (the Herfindahl-Hirschman Index) and the combined company's market share. Any merger creating a firm with more than a 30% market share in any relevant market would now be presumed to violate the Clayton Antitrust Act, even if one party contributes only a de minimis market share or the relevant market is otherwise fragmented, factors that historically likely would have mitigated any concerns about the competitive impact of the deal. For example, in the past, a 30% market share alone typically would not have been considered a threat to competition absent additional factors, such as the rest of the market being controlled by relatively few firms.

- Acquisitions by firms with a "dominant position" in any relevant market — defined as a 30% share — would be subject to heightened scrutiny to see if the acquisition will entrench that dominance or extend it into additional markets. However, nearly all courts have required much larger market shares (typically greater than 50%) to find that a company is dominant.

Deals That Would Be Uncontroversial Under Past Practices Could Be Challenged

Other changes would broaden the types of transactions that would be subject to close scrutiny and potentially challenges in court based on theories that are not supported by legal precedent.

- Transactions that could enable a firm "dominant" in one market to entrench or extend its position in other markets would be prohibited, even if one of the merging firms has no presence in those other markets and the transaction therefore does not reduce competition in those markets.

- A firm could be charged with violating the Clayton Act if it engages in an "anticompetitive pattern" of multiple small acquisitions, even if no individual acquisition would violate the antitrust laws. Relevant evidence here could include the acquirer's past M&A practices, including unconsummated deals in other markets or industries, and future potential acquisition strategies by the acquiring firm or others in the industry. Those considerations introduce subjective and/or speculative elements of intent into the analysis, making it harder for companies to anticipate how a deal will be greeted by regulators. Some commentators believe this provision is aimed at private equity firms.

- The guidelines assume that mergers may substantially lessen competition for buyers of labor, resulting in lower wages or slower wage growth, reduced benefits or working conditions, and/or other degradations of workplace quality. Merger enforcement historically has not focused on these types of concerns.

- Under the new guidelines, mergers can raise competitive concerns even if they do not neatly fit either the horizontal or vertical merger paradigm. The guidelines call out the risk from mergers that give an acquiring firm control over access to any product, service or customers that its rivals use to compete, as well as mergers involving multisided digital platforms that act as intermediaries — including those involving the same company both operating and participating in a platform.

- The guidelines urge an approach that allows the agencies to define the relevant market narrowly, which makes it more likely the agencies will find there to be an anticompetitive impact. The revisions also allow the agencies to ignore the impact of "significant substitutes" that fall outside the market definition used by the agencies.

The Revised Guidelines May Result in More Contested Deals but May Not Ultimately Alter the Legal Landscape

- The guidelines are subject to 60 days of public comment before they can be finalized. But, even if adopted by the agencies, they are not binding on courts and may not be persuasive given their departure from widely accepted principles of merger analysis. Specifically, the guidelines ignore many of the guiding economic principles underpinning decades of modern merger enforcement and are largely untethered from recent case law.

- The agencies' track record is poor when they have attempted to employ the principles reflected in the guidelines to block deals: The government has lost all but one of those merger challenges in federal court under Chair Khan and Assistant Attorney General Kanter.

- Despite those setbacks, the revised guidelines makes it clear that both agencies will continue to pursue aggressive — and to some degree, unpredictable — merger enforcement practices, particularly in industries that have been in the crosshairs of recent enforcement activity such as tech, health care and private equity.

- The guidelines also should be considered alongside the agencies' recent proposed changes to the merger notification requirements under the Hart-Scott-Rodino Act. If adopted, those would force companies to provide substantially more information and documents in the early stage of the merger review process. And that potentially could allow the agencies more opportunity to assess broader theories of harm under the guidelines.

For companies contemplating a merger, these recent agency proposals reinforce the importance of a well-considered strategy for weathering the antitrust review process.

Authors

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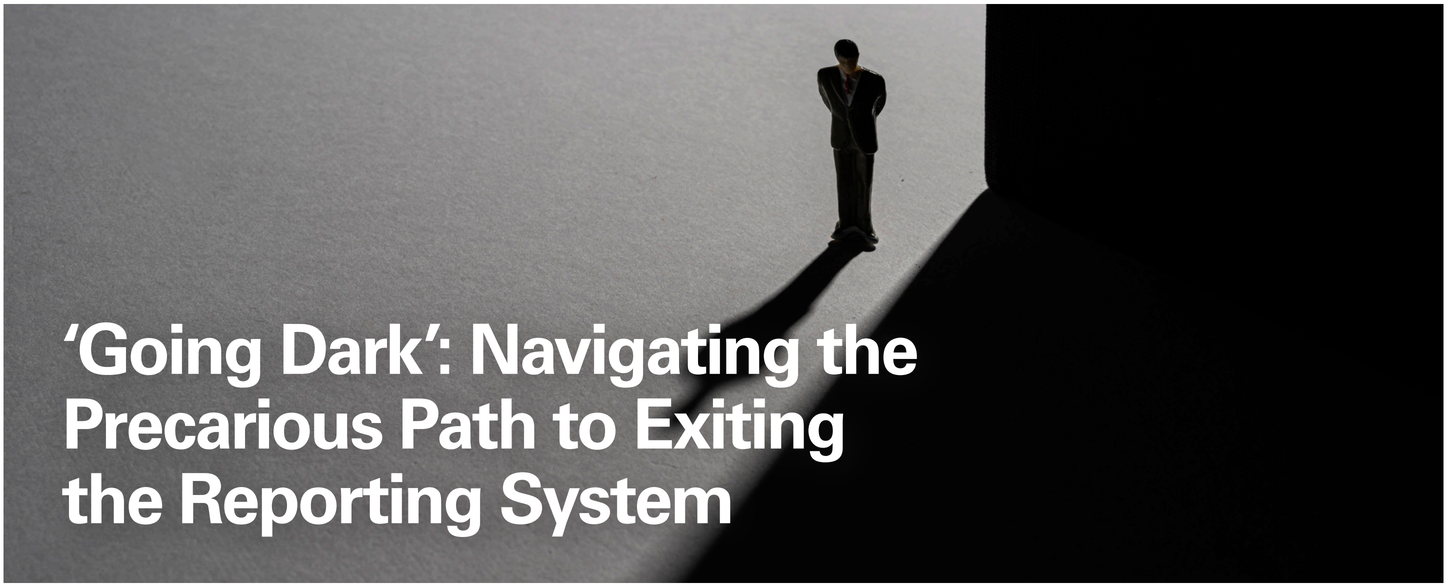

‘Going Dark’: Navigating the Precarious Path to Exiting the Reporting System

- Companies with sharply declining stock prices may find it beneficial to voluntarily exit the reporting system to reduce costs and eliminate compliance burdens.
- To reap the full rewards of “going dark,” a company should consider terminating or suspending its reporting obligations in addition to delisting.
- Some of the possible detriments and risks associated with going dark are not obvious, such as possible impacts on contracts and financings.

During periods of market turmoil and declining stock prices, companies may be tempted or pressured to delist and deregister their shares. This process is often referred to as “going dark.” Given the poor performance of companies that have recently entered the public markets and a dearth of favorable financing options, we anticipate that more companies will experience difficulty maintaining compliance with stock exchange minimum bid price and market capitalization requirements. Other companies may consider voluntarily going dark due to the costs and burdens of complying with exchange listing rules and the burdens of being a public company.

Voluntary Exchange Delistings

Public company boards often begin to consider the possibility of going dark when faced with challenges related to exchange listing standards or upon receipt of a delisting or non-compliance notice.

Sometimes it is possible to implement a plan to cure the non-compliance. If a notice is triggered by a company’s share price falling below the minimum bid price requirement, the company may consider a reverse stock split that decreases the number of issued shares by a specified ratio without affecting the total market capitalization.

Other paths to avoid an involuntary delisting include signaling to the market that a company is interested in finding a buyer or engaging in other strategic transactions. Of course, companies in this position should also be considering changes to business operations that would facilitate long-term growth prospects or other ways to execute current strategy to organically regain compliance.

Despite these efforts, companies sometimes conclude it is neither desirable nor feasible to maintain a listing. Reducing compliance costs and stepping out of the public eye may provide some breathing room to focus on fixing or growing the business.

It should be noted that some investors have come to expect companies to comply with the exchange-imposed governance and disclosure requirements even if a company delists, and auditors will likely require an independent audit committee.

Deregistration

It rarely makes sense to delist but maintain registration of a class of securities. Most companies faced with a delisting will also seek to deregister applicable classes of securities so they do not need to file periodic reports or otherwise comply with the requirements of the Securities Exchange Act of 1934 (Exchange Act). Deregistration is more complex than delisting, however, and requires a detailed analysis of how to efficiently terminate or suspend a company's reporting obligations.

Generally, a domestic U.S. company will need to have fewer than 300 stockholders of record in order to terminate or suspend its reporting obligations. (For these purposes, shares held in street name by a broker-dealer are held of record only by the broker-dealer, but for commercial depositories like the Depository Trust Company, each of the depository's accounts holding a company's shares will count as a distinct record holder.)

If a company has 300 or more stockholders, it may consider implementing a reverse stock split or tender offer in an effort to cash out stockholders with smaller holdings. But these are complex maneuvers that often require consideration of the board's fiduciary duties and may trigger more demanding "going private" disclosures under the Securities and Exchange Commission's rules. They may also require complex valuation and solvency determinations.

Bear in mind that some contractual agreements — in particular, debt financing arrangements — may require a company to make ongoing disclosures to the market.

Pros and Cons

Boards must understand the pros and cons associated with voluntarily going dark, regardless of the motivation, and we have found that boards are not always aware of all the disadvantages of going dark beyond the obvious reduction of liquidity. For example, a delisting or deregistration can trigger defaults under a company's debt financing agreements — exacerbating what may already be a precarious financial position. Before deciding to step out of the public eye, boards must weigh any perceived benefits against the complexity and risks of exiting the reporting system.

Potential Benefits of Going Dark	Potential Downsides and Pitfalls of Going Dark
Costs reduced by elimination of Exchange Act reporting. The burdens of being a public company are significant. Assuming a company is eligible to terminate its reporting obligations, it can achieve substantial cost savings	**Reduced liquidity and potential decrease in share price.** The initial announcement of the delisting is likely to result in a large decline in trading prices. Trading volumes and analyst coverage will decrease significantly after delisting and will be eliminated upon deregistration.
No need to comply with exchange governance and disclosure requirements. National exchanges impose disclosure and governance standards beyond those required by the federal securities laws, including additional independence requirements for audit and compensation committee members and various stockholder approval requirements.	**Reduced utility of the company's equity.** The securities of an unlisted company are less useful as currency for acquisitions and as a vehicle to raise equity capital, and they will be less attractive as equity-based compensation for employees.
Elimination of annual listing fees. A delisted company will not pay annual listing fees.	**Third-party approvals and consents may be required.** Some contracts and instruments may require that a company (or its parent guarantor) maintain its status as a listed and reporting company. Going dark may result in the company paying consent fees, or trigger default events or the acceleration of debt, which could offset any savings from a reduced compliance burden.
Ongoing trading (for a limited time). Upon delisting from a national securities exchange, the stock of a company that continues to file periodic reports with the SEC may continue to trade "over the counter" on decentralized markets, such as OTC Markets Group, providing continued (albeit reduced) liquidity for stockholders. Upon deregistration, however, much of this trading will likely cease.	**Significant compliance costs and expenses may remain.** A company that delists but does not deregister or is unable to deregister promptly will continue to bear the burdens complying with Exchange Act reporting requirements, including the need to produce annual and periodic reports, obtain Sarbanes-Oxley certifications from officers and directors, and hold annual stockholder meetings.
Enhanced focus. Removing public scrutiny and compliance-related distractions may result in management having more time to focus on growing the business.	**Potential for stockholder litigation.** Stockholders may bring litigation against the board of directors based on the decreased liquidity and decline in share price resulting from a delisting. A voluntary delisting that is not coupled with deregistering (and the associated cost savings) may result in increased stockholder skepticism.
	Deregistration takes time. While delisting is often a streamlined process, deregistration is more technical and is not immediate. Companies seeking to deregister will generally need to wait until 90 days after effectiveness of the delisting. There may also be circumstances where a company must continue filing Exchange Act reports for a longer period.
	Reputational damage. Going dark may negatively affect how a company is perceived by the market, its customers or lenders.

Things To Bear in Mind

For an imminent delisting by an exchange, or where a company decides voluntarily to delist and deregister, boards should:

- Be cognizant of requirements to keep stockholders informed.
- Communicate with other stakeholders about the company's plans.
- Assess the impact of delisting on commercial contracts, debt agreements, leases and employee equity plans.
- Review the company's equity and debt financing agreements to understand whether and how delisting or deregistration would trigger defaults or other issues under various covenants (*e.g.*, registration rights), and any related consequences.
- Consider, in consultation with counsel, whether and when the company may terminate or suspend its reporting obligations under the Exchange Act.

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The EU’s New ESG Disclosure Rules Could Spark Securities Litigation in the US

- The EU’s comprehensive new ESG disclosure requirements will force many multinationals with operations in Europe to decide how much information to disclose where, and to take measures to ensure their disclosures are consistent.
- The granular information required by the EU could feed litigation in the U.S. if the disclosures appear false or misleading, or are inconsistent with disclosures in other jurisdictions.
- With a new U.K. disclosure mandate and expected additional SEC disclosure rules, companies could face conflicting demands for ESG information from the EU, U.K. and U.S.

Corporate environmental, social and governance (ESG) initiatives and disclosures continue to be a focus for investors, other stakeholders and securities regulators in both the United States and Europe, but the disclosure rules remain fragmented across jurisdictions and potentially conflict. Although efforts are underway to establish a uniform international standard, jurisdictional differences are expected to persist.

This divergence in disclosure standards could result in unexpected liability for companies whose securities are traded in the U.S., especially as the European Union moves forward with a new set of comprehensive ESG reporting rules that could have extraterritorial application. The United Kingdom, too, recently adopted new ESG disclosure requirements that may not perfectly align with the EU’s.

U.S.-listed companies with a significant presence in the EU will need to consider the interplay between the EU reporting requirements and liability provisions under U.S. securities laws.

ESG Reporting in the US Today

Currently, ESG disclosures in the U.S. are dictated primarily by general principles and materiality. Other than a few specific disclosures required under Securities and Exchange Commission (SEC) rules (*e.g.*, cybersecurity risk governance and incidents, certain environmental legal proceedings, compliance with environmental laws and human capital management matters), companies generally need not make ESG disclosures in their SEC filings unless they are material to the company’s business.

The SEC, however, is looking to adopt more prescriptive and detailed ESG disclosure rules. For example, in March 2022, the agency issued proposed rules that would mandate highly detailed climate-related disclosures. In July 2023, it adopted more prescriptive disclosure rules on cybersecurity incidents and risk management processes. Additional disclosure rules are expected on board diversity and human capital management.

Even without specific disclosure requirements, many U.S. companies voluntarily disclose information about their current efforts and future commitments on ESG matters in response to requests from investors, interest groups, employees and other stakeholders. One study found that, in 2021, 99% of S&P 500 companies disclosed some level of ESG-related information outside of their SEC filings. These voluntary disclosures typically take the form of standalone ESG reports, company websites, responses to questionnaires from the non-profit CDP climate impact organization and/or third-party assurance or verification reports. Some companies have begun including some of these voluntary disclosures in their SEC filings, typically as ESG highlights in their proxy statements or annual reports.

The EU's New Comprehensive ESG Disclosure Requirements

A new EU law adopted at the end of 2022 (the Corporate Sustainability Reporting Directive, or CSRD) and the standards implementing it released in July 2023 (the European Sustainability Reporting Standards, or ESRS) require comprehensive, detailed disclosures covering a broad spectrum of sustainability topics.

Notably, the CSRD requires disclosures not only about how ESG issues impact a company's business, but also about the business's impact on a range of sustainability matters — referred to as "double materiality." The CSRD also requires third-party audits for all reported sustainability information. Thus, in many respects, the CSRD goes beyond existing U.S. requirements and even beyond the SEC's proposed ESG disclosure rules.

Initially, the CSRD will apply only to EU-incorporated companies. But for financial years starting on or after January 1, 2028, non-EU companies must report if they have a significant presence in the EU (defined by minimum EU revenue and asset thresholds) and they must report on a global, whole-group basis — *i.e.*, including all non-EU companies in the group.

As a result, many multinationals based outside the EU will need to start reporting under the detailed EU rules in 2029 and consider how to ensure compliance, as well as what EU compliance may mean for the corporation's obligations in other jurisdictions.

In a further twist, prior to the adoption of the CSRD, the U.K. amended its non-financial reporting requirements for U.K.-incorporated companies, requiring certain U.K. companies to report in

Standards	Sponsor(s)/Founders(s)
European Sustainability Reporting Standards (ESRS)*	European Union
Sustainability Disclosure Requirements (SDR) (proposed)*	U.K. Financial Conduct Authority
SEC Climate Disclosure Rules (proposed)*	U.S. Securities and Exchange Commission
IFRS Sustainability Disclosure Standards**	International Sustainability Standards Board (ISSB) of the International Financial Reporting Standards (IFRS) Foundation
SASB (Sustainability Accounting Standards Board) Standards	ISSB
Taskforce for Climate-related Financial Disclosures (TCFD) Standards	Financial Stability Board
Global Reporting Initiative (GRI)	United Nations Environment Programme, Ceres, Tellus Institute
Integrated Reporting Framework (IFR)	IFRS

line with guidelines established by the Taskforce for Climate-related Financial Disclosures (TCFD) of the international Financial Stability Board. The EU's reporting standards, the ESRS, are based on TCFD's standards, but the U.K. and EU regimes could nonetheless diverge.

The EU plans to allow disclosures made under similar rules in other jurisdictions to satisfy the EU requirements, which would reduce the risk of conflicting demands for multinationals. But it is not yet clear whether the U.K. regime or any new SEC rules will be deemed similar enough.

US Disclosure Liability Considerations

Under U.S. securities laws, all public company disclosures must be accurate and complete in all material respects and not materially misleading. Materially misleading or false statements or omissions may subject the company to private securities lawsuits as well as to SEC enforcement actions under various provisions of U.S. securities law. As a result, ESG disclosures, whether in SEC filings or other reports or on a company website, can create significant litigation and enforcement risks if not carefully prepared and reviewed.

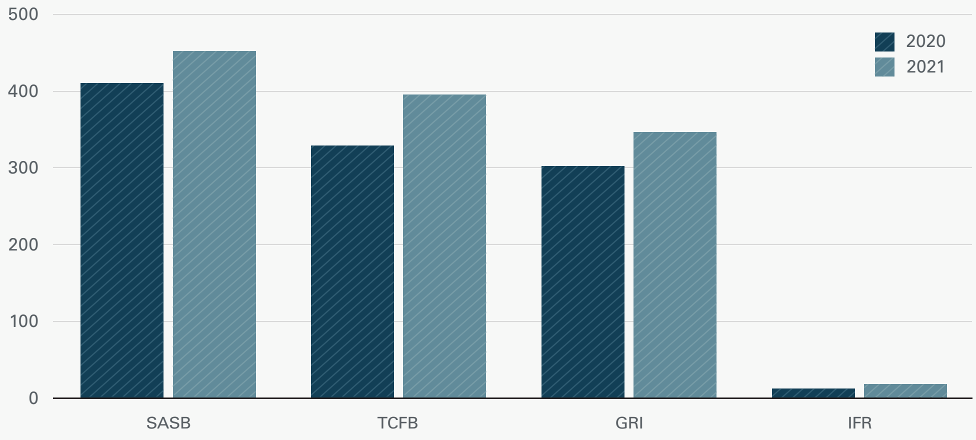
The SEC is already scrutinizing voluntary ESG statements. In March 2021, its Division of Enforcement created a Climate and ESG Task Force to analyze voluntary ESG disclosures in SEC filings and identify ESG-related misconduct. Last year, the Task Force brought its first enforcement action, a case against a Brazilian mining company alleging that it made false and misleading claims about the safety of its dams in sustainability reports as well as in SEC filings. In addition, recent staff comment letters on climate-related disclosures in corporate Form 10-K filings have asked companies whether they have considered including the same detailed climate-related disclosures in SEC filings that they have provided elsewhere.

Against this backdrop, companies that are subject to both U.S. securities laws and the CSRD need to pay particular attention to potential U.S. disclosure liability from providing expansive and

ESG Reporting Standards and Frameworks Used by S&P 500 Companies

Companies whose reports were prepared in accordance with or referenced these standards and frameworks.

Source: The Center for Audit Quality: www.thecaq.org/sp-500-and-esg-reporting



detailed ESG disclosures under the CSRD requirements. The anticipated issues that such companies would need to consider include the following:

- **Higher risk profile under U.S. securities laws.** Any public disclosures required under the CSRD would be subject to the anti-fraud provisions of U.S. securities laws and potential scrutiny by U.S. investors looking for statements that could be the basis for a lawsuit. For example, a U.S.-listed company that publishes global, group-wide ESG information only on its website or in an ESG report — primarily to comply with the CSRD and without including the same information in the company's SEC filings — may nevertheless face a U.S. investor lawsuit or SEC enforcement action based on that information. The risk could be heightened given the CSRD's requirements for granular disclosures that go beyond current SEC requirements.

- **Materiality determinations.** The CSRD may mandate disclosures that are not necessarily material or otherwise required for purposes of U.S. securities laws, which only ask whether a reasonable investor would consider the information to be important in making investment decisions. While the SEC staff generally does not second-guess companies' materiality determinations, it is important to maintain robust disclosure controls and procedures to assess and support materiality determinations for ESG disclosures, as well to monitor any perceived differences between SEC filings and CSRD-based disclosures or other voluntary reports.

- **Potentially conflicting disclosure requirements between the CSRD and SEC rules.** As the EU continues to refine the CSRD requirements and the SEC adopts additional ESG disclosure requirements, it is unclear whether and to what extent those requirements differ or converge. If the EU does not recognize equivalence and accept U.S. disclosures to satisfy its own requirements, companies will need to consider how best to meet the competing jurisdictional demands. That will entail weighing the risks of providing different levels of detail for subsidiaries in different countries or choosing to report according to one regime for all subsidiaries and affiliates with supplemental information as required.

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Podcast: Will the EU's Focus on Foreign Subsidies Make It More Difficult To Acquire European Businesses?

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Companies now face an additional regulatory hurdle when making acquisitions in the European Union. In addition to merger control and foreign direct investment (FDI) filings, they will be subject to the EU's new Foreign Subsidies Regulation (FSR), Skadden partner Giorgio Motta explains. The law, which took effect in July, allows the European Commission to look into acquisitions of, and investments in, businesses in Europe by non-EU companies that have received some sort of financial support from a non-EU government.

The FSR's reach is broad. For example, it is not limited to targets based in the EU. If a non-EU company buys another non-EU company and the target has substantial European operations, the companies may be required to report their transaction under the FSR, Ann Beth points out.

There are two economic thresholds: First, does the target have EU revenue of at least €500 million in the EU? Second, have the companies *together* received more than €50 million in non-EU government support in the past three years? The latter is quite a low threshold, so most companies that meet the revenue threshold will likely be required to notify the EC of the transaction and disclose government support they have received, Giorgio says.

Foreign financial contribution encompasses almost any financial flow between a company and any non-EU public body or private body whose actions can be attributed to a non-EU government. Even purchases of goods or services by or from a public entity on market terms count toward the €50 million threshold. For the types of financial contributions that the EC considers the most distortive — support to a failing business, unlimited guarantees, export financing or the funding of an M&A transaction — the EC will require more detailed disclosure.

The filing requirement applies to transactions signed on or after July 12, 2023, which have not been completed by October 12. No filings will be accepted before October 12, but the EC is inviting companies to come in and discuss the form and details of any potential notification before then.

The EC is likely to be concerned about transactions where the buyer may have been able to outbid other interested parties because of state ownership or subsidies, Giorgio says. That might also apply to private equity funds with sovereign wealth fund investors that provide advantageous financing, he adds.

Both acquirers and targets will want to perform additional due diligence on their counterparties to determine if there are risks the transaction could be blocked or delayed because of the FSR, and their merger agreement will need to provide for those risks, Ann Beth and Giorgio say.

Today virtually no companies systematically compile comprehensive information about all types of government support, Giorgio says. Because the FSR considers financial support globally, companies considering acquisitions in Europe will need to create systems to collect this type of information and keep it updated so they can respond quickly to M&A opportunities.

The best approach, Giorgio says, is to prioritize data on the types of support that the EC is mostly likely to fear will have the most distortive effect on competition in the EU, and/or support to strategic industries that the EC may want to protect. If your company is near or over the thresholds, we also generally recommend discussing with the commission how to narrow the disclosure required, he adds.

We do not expect many transactions to be blocked or be subject to remedies, Giorgio says. In most cases, the FSR filing will likely be just one additional layer of red tape for M&A deals. But companies will want to make sure in the due diligence phase that there is nothing that would trigger a more in-depth review that could affect the outcome or timing of the transaction.

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