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ENTIRE FAIRNESS LITIGATION

The Standing Demand Committee

By Robert B. Greco and Matthew D. Perri

Recently, corporations and fiduciaries have faced enhanced litigation risk arising from entire fairness claims challenging related-party transactions and other transactions implicating unique interests of corporate fiduciaries. This risk is most pertinent for controlled public corporations, although it has also affected public and private corporations with significant non-majority holders.

The prospect of costly entire fairness litigation has also proven to be ripe for exploitation by "entrepreneurial plaintiffs' lawyers,"[1] as this risk can alone supply plaintiffs with considerable settlement leverage. And this risk is not limited to the M&A sale transactions that have historically been the focus of stockholder litigation. Numerous other circumstances, such as financings and compensation awards, could implicate entire fairness review.

But importantly, Delaware Supreme Court decisions over the past several years have confirmed that challenges to these types of

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commercial arrangements and related-party transactions in the course of business are, in most cases, derivative claims.

In the first instance, bedrock Delaware law vests primary management authority over such claims in corporate boards, not stockholder-plaintiffs. As the Delaware Supreme Court has repeatedly emphasized, "it remains a 'cardinal precept' of Delaware law that independent and disinterested directors are generally in the best position to manage a corporation's affairs, including whether the corporation should exercise its legal rights," "even when it involves a controlling stockholder."[2] In order for a stockholder to be vested with standing to commence derivative litigation, the stockholder is required to establish demand futility.

To do so, a stockholder generally must allege particularized facts raising a reasonable doubt as to the independence and disinterestedness of at least half of the board. The demand futility requirement is an important safeguard that reinforces the management authority of boards and limits the exposure of corporations and their fiduciaries to inefficient derivative suits whose prosecution is not in a corporation's best interests.

Various dynamics shared among many public corporations may nevertheless limit the effectiveness of this safeguard and allow stockholders to wrest control of derivative claims by pleading demand futility. For example, controlled companies utilizing the "controlled company exemption" offered by the New York Stock Exchange and NASDAQ are not required to have an independent board majority. These corporations may face the greatest risk of entire fairness litigation and be most susceptible to stockholder-plaintiffs successfully establishing demand futility.

Even if a corporation has an independent board majority for stock exchange purposes, Delaware does not adhere to exchange independence standards. Instead, Delaware law employs a more fact-specific, case-by-case approach that has resulted in numerous directors deemed independent for exchange purposes having their independence impugned for purposes of demand futility based on factors such as long-time personal friendships, overlapping memberships in multiple exclusive golf clubs, and repeated appointments as an independent director by the same sponsor for multiple portfolio companies.

Even if a majority of a corporation's board is truly independent, demand futility is generally determined on a motion to dismiss. At this stage of the litigation, a stockholder need only raise a "reasonable doubt" as to the independence and disinterestedness of at least half of the board. And in doing so, a stockholder may rely on the specified facts alleged in the stockholder's own complaint, which are accepted as true even if cherry-picked or inaccurate, and all reasonable factual inferences that logically flow from these alleged facts. This heightened, yet still plaintiff-friendly, pleading standard may bolster a stockholder's demand futility arguments and could lead to a finding of demand futility based on allegations and inferences that may not hold true.

A Means for Solidifying Independent Director Authority Over Derivative Claims

A recent article in *The Business Lawyer* authored by a Richards, Layton & Finger director proposes a novel solution for corporations seeking to mitigate the growing risks and costs of entire fairness litigation by concentrating the authority over derivative litigation in a committee of independent directors.[3] This solution aligns with existing Delaware law, which views these independent directors as "generally in the best position" to manage derivative claims,[4] and involves the proactive establishment of a standing demand committee of independent directors vested with the sole and exclusive power and

authority over derivative litigation demands and related matters.

As the article more thoroughly explains, based on specific statutory authority in Delaware's General Corporation Law, longstanding foundational principles of Delaware corporate law, and an overlooked aspect of the seminal duty of oversight case *Marchand v. Barnhill*, the establishment of a standing demand committee by charter provision[5] should result in demand futility being assessed based on the independence and disinterestedness of the members of the committee rather than the independence and disinterestedness of the entire board.

That is, demand futility should presumably be assessed based on the independence of the committee members, who are presumably appointed to the committee, at least in large part, due to their independence, and without being negatively affected by the array of potentially interested directors—such as executive directors, founders, family members of interested persons, and representatives of large investors—who are often detrimental in efforts to rebut allegations of demand futility.

This would solidify independent director authority over derivative claims, promoting more efficient management of derivative claims and reducing the costs of opportunistic derivative litigation currently faced by many corporations, without necessarily invoking the heightened standard of review that applies when a special litigation committee—a distinct type of investigative committee formed after a stockholder-plaintiff has already filed derivative litigation—conducts an investigation and seeks dismissal of the litigation.

The standing demand committee is a viable solution for not only newly public corporations conducting an IPO but also existing public and private corporations. This includes even existing controlled public corporations. The article explains that, based on Delaware public policy and precedent, there is reason to believe that the establishment of a standing demand committee on a "clear day" should generally be afforded the protections of the business judgment rule, a conclusion which has been bolstered by the Delaware Supreme Court's recent decision rejecting speculative alleged litigation protections as a basis for subjecting TripAdvisor, Inc.'s proposed move to Nevada to entire fairness review.[6]

Overview of Demand Committees

A demand committee is a flexible vehicle for independent directors to assess and respond to stockholder concerns regarding corporate events. Much like a sale process, there is no single blueprint that a demand committee must adhere to in assessing stockholder demands. Nevertheless, many demand committee processes tend to proceed along the same general path.

A properly empowered committee will have the ability to retain advisors to represent the committee. Often the first advisor hired by a committee is independent legal counsel. A standing demand committee may find it advisable to protectively retain independent counsel upon formation of the committee to assist when and as demands or other matters may be presented to the committee. Independent counsel should have an expertise in the process-related aspects of considering and responding to stockholder demands, including the fiduciary duties owed by committee members.

Once independent counsel is engaged and a stockholder demand is directed to the committee, counsel should first assess the independence of the committee members with respect to the subject matter of the demand. Independent counsel can then assist throughout the committee process by advising the committee in satisfying its mandate, as well as in documenting the committee process and handling aspects of its investigation along the way.

After counsel is engaged and the committee's independence is confirmed, a demand committee can embark on its principal obligations upon receiving a stockholder demand: (i) determining "the best method to inform [itself] of the facts relating to the alleged wrongdoing and the considerations, both legal and financial, bearing on a response to the demand"; and (ii) weighing "the alternatives available to it, including the advisability of implementing internal corrective action and commencing legal proceedings."[7]

The appropriate process for a demand committee to follow should be determined on a case-by-case basis based on the best interests of the corporation. Thus, after engaging independent counsel, a committee should work to develop and proceed with a process tailored to the corporation's situation, including its needs and resources, and the particularized allegations made in the demand. With the assistance of independent counsel, demand committees have the flexibility to employ a process that takes advantage of potential efficiencies when appropriate.

This may include, when appropriate, relying on the corporation's outside counsel or other representatives to make use of their subject matter expertise or to efficiently gather factual information. Other potential factors that are regularly considered by demand committees include the specificity of the allegations in the demand, the burden on executives and employees in assisting with the investigation into the allegations, the disruption to the corporation associated with the committee's process and investigation, the pendency of regulatory investigations or other litigation or proceedings, and the monetary costs of conducting any investigations. Based on these and other appropriate considerations, committees may occasionally temporarily defer investigation into a demand.[8]

When beginning its investigation, a common first step for demand committees is to request relevant documentation from the management team and/or advisors of the corporation. These document requests may vary widely based on the readily available record and the subject matter of the demand. The committee can often start its investigation based on a discrete set of documents or records that have already been created by the corporation or are easily accessible.

Depending on the matters alleged in the demand, the committee's familiarity with these matters, the available records of the corporation, the merits of the demand, and any other relevant considerations, this first step may comprise a large part (or even all) of the committee's investigative process or it may only be the beginning of the committee's investigation. For example, when the matters raised in the demand have already been the subject of a prior investigation or proceeding, the committee may be able to rely heavily on the record and information already collected or compiled for that purpose.

During the committee's investigation, documents collected are typically reviewed in the first instance by committee counsel. After counsel reports to the committee on the results of its review, the committee may evaluate the necessity and scope of conducting any further investigation, which may include additional document requests and/or interviews with relevant individuals.

In deciding whether to conduct additional investigation, the committee members should, consistent with their fiduciary duties, consider the associated burdens and costs imposed on the corporation, including those that would arise from collecting and reviewing any additional documents, conducting any interviews, and the incremental fees and expenses of outside counsel. The committee should balance these and any other relevant considerations against, among other things, the likelihood of obtaining any new or useful information and the potential utility of any new or useful information in informing the committee's response to the demand and the corporation's potential remedies with respect thereto.

In this regard, the demand committee process presents considerable efficiencies in comparison to stockholder-initiated derivative litigation, in

which representative counsel is generally incentivized to seek discovery irrespective of its cost to the corporation.[9]

If the committee elects to conduct further investigation, interviews may be used to gather additional facts regarding the underlying events and documents. A properly established committee is vested with the full authority of the board of directors and empowered to require current executives and other employees to participate in an interview.[10] Committees tend to rely on counsel to conduct the bulk of any interviews.[11] During any interviews, there are no inherent subject matter limitations on the questions that may be asked, and it is not uncommon to interview a key participant more than once as facts emerge and the investigation develops. An interviewee can be refreshed on specific documents in advance of an interview to aid his or her recollection on particular issues, and the privilege concerns common in depositions are often minimized in this context.

Once a committee is satisfied that it is equipped with sufficient information to assess the demand and inform its response to it, and that further investigative efforts are not in the corporation's best interests, the committee should form a view of the demand and determine the appropriate response, if any, to the demand and the allegations made therein. To assist with the committee's decision-making process, counsel may prepare a presentation or report to present to the committee.

Where a presentation or report is prepared, it will often be accompanied by a compilation of key documents or information on any important matters. In determining the appropriate response to the stockholder's demand and allegations, the committee must evaluate potential alternatives and decide, in its business judgment, which response is advisable and in the best interest of the corporation. In this regard, the committee should examine any considerations relevant to the costs or benefits of a particular response.

Relevant considerations may include, among other things, those relating to the potential direct and indirect costs of prosecuting any claims that may arise from the demand's allegations (such as defense costs, indemnification and advancement costs, diversion of company resources, and negative publicity); the likelihood of recovery for any such claims and the potential amount of any recovery; the effectiveness of any internal corrective measures, sanctions or other remedial actions; potential distractions and possible effects on morale and relationships among executives and other employees; and potential reactions from and effects on relationships with customers, suppliers, capital providers, and other counterparties.

After weighing any relevant considerations, the committee could reach a wide array of different outcomes, which may include deferring further investigation, taking no action, proactively improving aspects of the corporation through policy or personnel changes or other remedial measures, or attempting to remedy any harm that the committee deems possible or likely to have arisen from the demand's allegations through internal action or litigation.

After conducting its investigation, an independent and disinterested demand committee's decision is accorded deference and subject to the protections of the business judgment rule.

Notes

1. *W. Palm Beach Firefighters' Pension Fund v. Moelis & Co.*, 310 A.3d 985, 998 (Del. Ch. 2024); *see also In re Revlon, Inc. S'holders Litig.*, 990 A.2d 940, 959 n.6 (Del. Ch. 2010) (discussing agency problems arising from the prosecution of derivative litigation by "entrepreneurial litigators").

2. *In re Match Grp., Inc. Deriv. Litig.*, 315 A.3d 446, 469 (Del. 2024) (quoting *United Food & Com. Workers Union & Participating Food Indus. Emps. Tri-State Pension Fund v. Zuckerberg*, 262 A.3d 1034, 1056 (Del. 2021)).

3. Robert B. Greco, *A Corporate Governance Solution to the Inefficiencies of Entire Fairness*, 79 Bus. Law. 993 (2024).

4. *Match*, 315 A.3d at 469.

5. The article further posits that a charter amendment may not necessarily be needed to produce this shift in the assessment of demand futility. As the Delaware Supreme Court explained nearly 100 years ago, "[t]he right of a stockholder to file [a derivative action] to litigate corporate rights is . . . solely for the purpose of preventing injustice, where it is apparent that material corporate rights would not otherwise be protected." *Sohland v. Baker*, 141 A. 277, 282 (Del. 1927). Where a standing demand review committee of independent directors is established by bylaw or board resolution, an independent committee would be empowered and positioned to protect valuable corporate litigation claims and prevent injustice. This independent committee would be not only duty bound by the directors' fiduciary duties to carry out this mandate, but also would be comprised of the independent and disinterested directors that Delaware law has long deemed best equipped to do so. Delaware law affords stockholders derivative standing "solely to prevent an otherwise complete failure of justice" in circumstances where a corporation's derivative claims would not otherwise be protected, and such circumstances would not exist where authority over those claims is left with those Delaware law considers best positioned to protect them. *Schoon v. Smith*, 953 A.2d 196, 202 (Del. 2008) (quoting 4 Pomeroy's Equity Jurisprudence § 1095, at 278 (5th ed. 1941)).

6. *Maffei v. Palkon*, — A.3d —-, 2025 WL 384054 (Del. Feb. 4, 2025).

7. *Rales v. Blasband*, 634 A.2d 927, 935 (Del. 1993).

8. Deferral may not be available or reasonable in all circumstances, including because deferral without proper protections could inhibit the corporation's ability to remedy wrongdoing. Informed decisions to defer at least portions of investigations are more common when the subject matter of a demand is already the subject of a pending regulatory investigation or another litigation or proceeding involving the corporation. An immediate internal investigation could affect the corporation's ability to optimally resolve any such investigations, litigations, or proceedings. Deferring a committee's investigation may also present significant efficiencies by allowing the committee to utilize records created as part of the external investigations, litigations, or proceedings.

9. Moreover, sharing privileged materials with a demand committee generally does not jeopardize privilege or present the same concerns as producing privileged materials to counsel prosecuting stockholder-initiated litigation. Accordingly, while significant costs are often incurred in derivative litigation through the privilege review that must be conducted before materials are produced to stockholder-plaintiffs, these costs may be avoided when materials are compiled and prepared for a demand committee. The lack of confidentiality concerns in the demand committee process may present similar efficiencies.

10. Demand committees do not have subpoena power and, absent contractual agreements, may find it difficult to compel former executives or other employees or third-party representatives to sit for interviews.

11. During the committee process, a demand committee is entitled to rely on counsel and the information, opinions, reports, and statements provided during its investigation. 8 *Del. C.* § 141(e).

The Passive/Aggressive Investor: Significant New SEC Staff Interpretive Guidance on Schedule 13G Eligibility

By Ron Mueller, Jim Moloney, Aaron Briggs, Beth Ising, Tom Kim, Brian Lane, Lori Zyskowski, Mickal Haile, and Matt Staugaard

On February 11, 2025, the Staff in the Division of Corporation Finance (Staff) of the U.S. Securities and Exchange Commission (SEC or the Commission) issued updated and new Compliance and Disclosure Interpretations (C&DIs)[1] that are likely to significantly impact how investors engage with public companies. These interpretations address beneficial ownership reporting on Schedule 13G vs. Schedule 13D (13G and 13D, respectively), expand the nature and scope of activities the Staff views as "influencing control of the issuer" (which could deter otherwise passive investors who own more than 5% of a company's voting securities from certain forms of engagement to avoid becoming ineligible to rely on 13G reporting), and could require groups of smaller social activist shareholders to become subject to 13D reporting.

The Staff's recent guidance underscores the agency's increasing scrutiny of institutional investors' corporate governance stewardship activities, particularly in the context of environmental, social, and governance (ESG) matters.

Key Changes to 13G Filing Eligibility Standards

Shareholders, including those acting as a group, that beneficially own more than 5% of a class of registered voting securities must report their ownership on either a 13G or a 13D. To maintain eligibility to report on 13G instead of 13D,[2] a shareholder must certify that the subject securities "were not acquired and are not held for the purpose of or with the effect of changing or influencing the control of the issuer." A 13D requires more detailed information on a shareholder's beneficial ownership of and transactions in a subject company's shares, as well as its plans and proposals with respect to the company and requires prompt amendments for any material changes in the reported information.

1. 13G Filing Eligibility and Shareholder Engagement.

In revised C&DI 103.11, the Staff reaffirmed that a shareholder's inability to rely on the Hart-Scott-Rodino Act's exemption from notification and waiting period requirements for an acquisition made "solely for the purpose of investment" would not affect a shareholder's ability

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to report on 13G. The Staff emphasized that a shareholder's ability to report on 13G instead depends on whether its activities suggest an intent to influence control of the company. The guidance reminds investors that such determination necessarily entails a factual analysis of the shareholder's actions and intentions in relation to "control" as defined under Exchange Act Rule 12b-2.[3] Notably, as shown by the redline that the Staff now provides when it revises its C&DIs, the Staff withdrew its prior guidance that engagement with a company on executive compensation, environmental, social, or other public interest issues, or on corporate governance topics unrelated to a specific change of control, without more, would generally not cause a loss of 13G eligibility.

2. Actions Constituting a "Purpose or Effect of Influencing Control".

In new C&DI 103.12, the Staff addresses circumstances that in its view would preclude an investor from reporting on 13G because it held securities with a disqualifying "purpose or effect of changing or influencing control of the issuer." The interpretation makes clear that a shareholder exerting "pressure" to adopt governance measures, particularly tied to ESG or political policy matters, may be viewed as an attempt to influence control over the company.

When Does Engagement with Management Cross the Line?

The new and revised C&DIs state that engaging with a company's management on corporate governance or other policy matters could, depending on all the relevant facts and circumstances, result in a disqualification from reporting on 13G. This is particularly relevant for investors whose activities, though intended to push for governance changes or ESG-driven policies, may be interpreted as attempts to influence control. The Staff's recent interpretation aligns with comments made by SEC Acting Chairman Mark Uyeda, who previously stated that asset managers' voting policies on ESG matters may qualify as attempts to exert control over management.[4] According to the Staff, investors exerting pressure on management to implement specific measures or changes to a policy would be influencing control over the company. Such examples of exerting pressure over the company include the following:

1. *Subject Matter Engagement*: Shareholders engaging with management to specifically call for control-related actions – such as a sale of the company or a significant amount of assets, restructuring, or the election of director nominees other than the company's nominees – would be disqualified from 13G eligibility solely due to the subject matter of the discussion or communications.

2. *Context of Engagement*: Under C&DI 103.12, a "shareholder who discusses with management its views on a particular topic and how its views may inform its voting decisions, without more, would not be disqualified from reporting on a Schedule 13G." However, "pressuring" management to adopt specific measures or tying support for directors to the adoption of certain proposals (*g.*, removal of staggered boards, changes to executive compensation practices, eliminating poison pill rights plans, undertaking specific actions relating to an environmental, social, or political policy, and stating or implying during any such discussions that it will not support one or more of the company's director nominees at the next annual meeting as a means of "pressuring" a company to adopt a particular recommendation) may also risk the loss of 13G eligibility. "Pressure" can be direct or indirect, express or implied.

SEC Guidance on 13D Group Formation

The Staff's guidance should be read in conjunction with the SEC's October 2023 Release,[5] which described examples of activities and/or communications that would not give rise to

formation of a Section 13(d) group. According to the Commission, the following scenarios would **not** give rise to group formation:

1. *Discussions in private or public forums*: Meetings between two parties or an independent, free exchange of ideas among shareholders at a conference, without the intent to engage in concerted actions or agreements related to securities acquisition, holding, or disposition, are not considered group activity.

2. *Discussions with company management*: Engaging with company management and other shareholders to jointly recommend board structure and composition, without discussing individual directors, expanding the board, or pressuring the board to take specific actions, does not form a group.

3. *Non-binding shareholder proposals*: Having conversations about or submitting a non-binding shareholder proposal jointly with others does not constitute group activity.

4. *Conversations with activist investors*: Conversations, emails, phone calls, or meetings between a shareholder and an activist investor seeking support for proposals, without further coordinated actions, are not considered group activity.

5. *Announcement of voting intentions*: Announcing an intention to vote in favor of an unaffiliated activist investor's director nominees, without further coordinated activity, does not form a group.

In contrast, a substantial shareholder sharing information with the intent of inducing others to purchase the same stock, where those purchases directly result from the information shared, could raise the possibility of group formation.

These scenarios provided by the Commission offer useful guidance for investors who may communicate with a public company and its shareholders, but do not want to inadvertently become a member of a group.

Implications and Possible Impact of the Staff's Interpretations

The Staff's views expressed in the C&DIs foreshadow stricter scrutiny on passive investors' 13G status and create new risks for investors (or groups of investors) when communicating with management and boards at public companies. The new C&DI introduces the concept of "pressure," which will be difficult to administer in practice and is, ultimately, a subjective standard. Investors should be mindful of the risk that, if a company believes the investor has crossed the line to "pressure" the company, it may contact the Staff to question whether the investor should be filing on a 13D and provide more details on its beneficial ownership and related transactions, as well as its intentions, including any plans or proposals, with respect to the company. The only example of "pressure" that is provided in the C&DIs is conditioning support for the company's director nominees at the next election of directors.

While these interpretations should rein in the minority of 13G filers who campaign on various ESG issues subject to a threat of voting against directors, they will likely influence the actions of large institutional investors who in recent years have sought to address ESG matters through their own "board accountability" voting policy standards (which those institutions have in recent years increasingly relied on in lieu of supporting shareholder proposals on such issues). The interpretations also raise the possibility that groups of investors that collectively own more than 5% of a company's stock, including smaller social activist investors that individually hold less than 5% of a company's stock, could be viewed as forming a 13D group if they coordinate to urge companies to adopt specific climate-change, diversity, equity and inclusion, or other ESG policies, particularly if backed by pressure through a "vote no" campaign.

The updated C&DIs should prompt investors who are reporting on 13G, as well as smaller activist investors who are not 13D or 13G filers but have signed on to various ESG letter-writing and other campaigns, to reassess their strategies.

Passive investors who have traditionally filed on 13G despite pushing for governance or ESG-related changes should now assess whether their actions could be seen as attempts to exert "pressure" and may need to change their approach to protect their 13G eligibility.

While it is theoretically possible for investors reporting on 13G to temporarily opt to report on 13D, many mutual funds and other investors face institutional or practical restrictions that make 13D reporting unrealistic. As a result, those investors may seek to avoid or minimize any communications that could be viewed as exerting "pressure" or attempts to exert control. Passive investors who chose to migrate from 13G to 13D in situations where communications relate to control-related issues or rise to the level of "pressure" may be able to revert back to 13G reporting once the shareholder engagement is completed and a vote taken on the matter at hand.

There are other notable collateral, and possibly unintended, consequences of the Staff's revised interpretations. For example, companies engaged in a proxy contest may find it more difficult to engage with their largest institutional investors, as those investors may be concerned that expressing views on issues arising in the contest could be viewed as pressuring company management and, therefore, triggering 13D reporting.

Ironically, if faced with less transparency from their large institutional shareholders, companies may become more reliant on engaging with and attempting to sway the major proxy advisory firms. Even outside of the context of an actual proxy contest, another unintended consequence may be a stifling of dialogue between large institutional investors and companies, a decrease in transparency on how these investors intend to vote, and possibly an increase in abstentions.

Practical Considerations for Investors and Companies

The Staff's updated guidance on 13G eligibility risks chilling the type of routine engagement that many companies have sought to foster and believe better positions them with their investors to help ward off proxy contests and other forms of traditional activism. With respect to the upcoming proxy season, we understand that some investors have already begun canceling or delaying long-scheduled engagements with companies as they assess the implications of the Staff's guidance. As a result, companies may need to consider enhancing their disclosures and considering alternative additional solicitation strategies to ensure they are effectively communicating their key messages to investors.

Nevertheless, while the determination of whether an investor is acting with a control purpose or intent will depend on all the relevant facts and circumstances, there are some guideposts that investors and companies should bear in mind:

1. The C&DI expressly states that a shareholder who discusses with management its views on a particular topic and how its views may inform its voting decisions, without more, generally would not be disqualified from reporting on a 13G.

2. Discussions around non-binding proposals, such as votes on management's say-on-pay proposals and discussions with non-proponents regarding shareholder proposals, should present less risk of being viewed as applying pressure on management or attempting to influence control of the company.

3. Investor responses to company-initiated inquiries regarding the investor's views on a particular issue, and investor references to other companies' practices or disclosures that the investor views as favorable, without more, should present less risk of being viewed as applying pressure on management or attempting to influence control of the company. As a result, companies will need to be more proactive in requesting engagement with investors and asking questions about key topics during those engagements.

4. Companies and investors may explore additional steps to foster productive discussions

that avoid creating a mis-impression that an investor is seeking to apply pressure when that is not the investor's intent. For example, when applicable, some investors might seek to clarify with a company that voting decisions are made on a case-by-case basis, by a committee, or by individual portfolio managers, and therefore that the investor's engagement team should not be viewed as representing how the investor will vote on a particular matter.

5. The C&DI notes the context in which an engagement occurs is highly relevant in determining whether a shareholder is holding securities with a disqualifying purpose or effect of "influencing" control of the company and, as such, off-season engagements may present less risk of losing 13G eligibility.

Ultimately, the latest C&DIs are likely to chill institutional investors' willingness to engage with companies as candidly as in recent years and could lead to unexpected negative votes on director elections, say on pay, or other matters. As a result, companies and boards will need to stay highly attuned to investor sentiment as expressed through other means, such as voting policies and public statements, and seek to maintain open channels of communication year-round to avoid these risks and ensure alignment on key governance and ESG matters. Companies and boards are encouraged to review their shareholder engagement activities, and consult with outside counsel as needed, on specific situations considering the Staff's new guidance.

Conclusion

The Staff's latest guidance signals a more stringent approach to shareholder activism, with a new emphasis on engagement as a factor that may cause a shareholder to lose its 13G eligibility. Shareholders who have traditionally been viewed as passive should be more mindful of how their actions (overt or implicit) and communications with management and boards may be seen as constituting "pressure," particularly with respect to governance, environmental, social, and political policy matters. In many instances, views as to what amounts to "pressure" may be in the eye of the beholder. As a result, we recommend training, clarifying ground rules between parties, and avoiding one-on-one communications between companies and shareholders.

Notes

1. Specifically, the Staff revised Question 103.11 and issued a new Question 103.12 under "Exchange Act Sections 13(d) and 13(g) and Regulation 13D-G Beneficial Ownership Reporting."

2. Rule 13d-1(b) and Rule 13d-1(c) require the shareholder to certify that the securities were not acquired and are not held with a disqualifying purpose or effect. Any person who acquired beneficial ownership before a company's voting securities were registered under the Exchange Act can report on 13G pursuant to Rule 13d-1(d) regardless of control over the company.

3. Exchange Act Rule 12b-2 defines "control" (including the terms "controlling," "controlled by" and "under common control with") as "the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract, or otherwise."

4. U.S. Securities & Exchange Comm., Nov. 17, 2022, *https://www.sec.gov/news/speech/uyeda-remarks-cato-summit-financial-regulation-111722* (remarks of Comm. Uyeda at Cato Summit on Financial Regulation).

5. *See* SEC Release Nos. 33-11253; 34-98704 (Oct. 10, 2023) at *https://www.sec.gov/files/rules/final/2023/33-11253.pdf*.

SEC Staff Issues New Guidance for Rule 14a-8 No-Action Review: Reinstates Need for "Nexus" between Social Policy Issues and the Company's Business

By Lyuba Golster, Ade Heyliger, and Julie Rong

In February, with the 2025 proxy season well underway, the Staff of the U.S. Securities and Exchange Commission (SEC) Division of Corporation Finance (the "Staff") issued Staff Legal Bulletin No. 14M (SLB 14M) revising guidance on the exclusion of shareholder proposals submitted pursuant to Exchange Act Rule 14a-8, specifically under Rule 14a-8(i)(5) (economic relevance) and Rule 14a-8(i)(7) (ordinary business). Most notably, SLB 14M rescinds Staff Legal Bulletin No. 14L (SLB 14L) issued in November 2021 and reinstates certain guidance from prior Staff Legal Bulletin Nos. 14I, 14J, and 14K (collectively, the "Prior SLBs"), which had been rescinded by SLB 14L. SLB 14M also addresses a number of technical interpretive issues.

SLB 14L has resulted in an increase in the number and scope of shareholder proposals, particularly those raising "ESG" and other matters of potential ethical and/or social significance, and in fewer companies receiving no-action relief on the basis of the ordinary business and economic relevance exclusions. SLB 14M marks a return to the traditional administration of Rule 14a-8 in place prior to SLB 14L.

Under the reinstated framework of the Prior SLBs, the Staff will consider whether a proposal raising a policy issue with broad societal impact is significantly related to a particular company's business, in the case of Rule 14a-8(i)(5), or is focused on a significant policy issue that has a sufficient nexus to a particular company, in the case of Rule 14a-8(i)(7). We expect that the SLB 14M framework will broaden companies' ability to exclude shareholder proposals under Rules 14a-8(i)(5) and (i)(7), including those focused on ESG and anti-ESG matters.

Companies that have received shareholder proposals for an upcoming annual meeting should reexamine their approach to seeking no-action relief in light of this new guidance. Companies that have already filed no-action requests are permitted to submit supplemental correspondence that raises new legal arguments in light of SLB 14M. Furthermore, companies for whom the deadline prescribed in Rule 14a-8(j) has passed are permitted to submit new no-action requests if these no-action requests concern new legal arguments raised by the publication of SLB 14M. All supplemental correspondence should be submitted as soon as possible.

"Ordinary Business" Exclusion – Rule 14a-8(i)(7)

The "ordinary business" exclusion under Rule 14a-8(i)(7) was designed to allow the exclusion of shareholder proposals dealing with "ordinary business" operations, which are in the domain of management and the board, unless the proposal raised a significant policy issue. Pursuant to the Staff's traditional framework for evaluating no-action requests to exclude a proposal on ordinary business grounds, a "significant" policy is one that (i) transcends day-to-day business matters and (ii) is significant to the company's business. SLB 14M reestablishes the importance of the "significant to the company" prong of the framework, which was severely pared back under SLB 14L.

In issuing SLB 14L in 2021, the Staff, citing difficulty in determining whether there was a

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sufficient "nexus" between the policy issued raised by the proposal and the particular company's business, essentially eliminated the focus on such "nexus." As a result of SLB 14L, shareholder proposals that were previously viewed as excludable because they did not raise a policy issue "of significance to the company" – citing climate change and human capital management as two such policy issue examples – were no longer viewed as excludable pursuant to the Rule 14a-8(i)(7) ordinary business exception, or pursuant to the Rule 14a-8(i)(5) economic relevance exception.

In issuing SLB 14M and rescinding SLB 14L, the Staff is returning to its traditional evaluation framework – *i.e.*, rather than focusing solely on whether a proposal raises a policy issue with broad societal impact or whether particular issues or categories of issues are universally "significant," the Staff will take a company-specific approach to evaluate whether the proposal deals with a matter relating to an individual company's ordinary business operations or raises a policy issue that transcends the individual company's ordinary business operations. Under this company-specific approach, a policy issue that is significant to one company may not be significant to another.

Rather, the Staff will take a "case-by-case" consideration of a particular company's facts and circumstances in its analysis of shareholder proposals that raise significant policy issues. To that end, in the case of Rule 14a-8(i)(7) ordinary business exception, the Staff will again consider whether a proposal focuses on a significant policy issue that has "a sufficient nexus to the particular company."

Micromanagement Prong – Rule 14a-8(i)(7)

SLB 14M also reinstates the Staff's guidance on the "micromanagement" prong of Rule 14a-8(i)(7) contained in certain enumerated sections of the Prior SLBs previously rescinded by SLB 14L. Specifically, the Prior SLBs focus on the degree to which a proposal "micromanages" the company "by probing too deeply into matters of a complex nature upon which shareholders, as a group, would not be in a position to make an informed judgment." The analysis focuses on whether a proposal seeks intricate detail or imposes a specific strategy, method, action, outcome, or timeline on management for addressing a significant issue in a way that supplanted the board and management's judgment in managing matters of a complex nature.

Under this framework, if a method or strategy for implementing the action requested by the proposal is overly prescriptive in a way that limits the judgment and discretion of the board and management, the proposal may be viewed as micromanaging the company. For instance, the Prior SLBs cited a proposal to generate a plan to reach net-zero greenhouse gas emissions by the year 2030, which sought to impose specific timeframes or methods for implementing complex policies, and a proposal seeking annual reporting on short-, medium- and long-term greenhouse gas targets aligned with the greenhouse gas reduction goals established by the Paris Climate Agreement, as examples of proposals excludable under micromanagement grounds.

In rescinding the Prior SLBs with the issuance of SLB 14L, the Staff adopted the view that proposals seeking detail or seeking to promote timeframes or methods were no longer *per se* micromanagement, and instead, the Staff focused on the level of granularity sought in the proposal, and whether and to what extent it inappropriately limited discretion of the board or management. SLB14M now reinstates the micromanagement evaluation guidance contained in the Prior SLBs.

"Economic Relevance" Exclusion – Rule 14a-8(i)(5)

SLB 14M reinvigorates the economic relevance exclusion under Rule 14a-8(i)(5) by reintroducing an analysis that was described under the Prior

SLBs. The economic relevance exclusion of Rule 14a-8(i)(5) permits a company to seek to exclude a proposal that "relates to operations which account for less than 5 percent of the company's total assets at the end of its most recent fiscal year, and for less than 5 percent of its net earnings and gross sales for its most recent fiscal year, and is not otherwise significantly related to the company's business." Under the SLB 14M framework, companies should now have a strong basis to challenge shareholder proposals that could raise significant social policy issues, but that are not economically significant to a company.

SLB 14L had essentially done away with the prior company-specific significance assessment, and allowed proposals to survive a request for exclusion when they raised issues of broad social or ethical concern, even if the relevant business fell below the 14a-8(i)(5) economic thresholds. Further, as noted in SLB 14M, the analysis of whether a proposal is "otherwise significantly related" under Rule 14a-8(i)(5) has at times been informed by its analysis under the "ordinary business" exception, Rule 14a-8(i)(7). As a result, the availability or unavailability of Rule 14a-8(i)(7) has at times been largely determinative of the availability or unavailability of Rule 14a-8(i)(5).

SLB 14M realigns the Staff's analysis with its prior focus on whether the proposal is significantly related to the particular company's business, rather than their importance in the abstract. SLB 14M also makes clear that the Staff will no longer look to its analysis under Rule 14a-8(i)(7) when evaluating arguments under Rule 14a-8(i)(5) and will analyze these exceptions independently.

Board Analyses

Prior SLBs encouraged companies to include with their ordinary business and economic relevance exclusion no-action requests a discussion reflecting the board's analysis of the particular policy issue raised and its significance to the company, under the belief that the board was better positioned to determine whether a matter was "not otherwise significantly related to the company's business."

However, SLB 14M notes that in the Staff's experience with board analyses, in most instances the information needed for the Staff's analysis was not included and board analyses did not generally have a dispositive effect. Therefore, with the issuance of SLB 14M, the Staff will no longer *expect* a company's no-action request to include a board analysis of the particular policy issue raised and its significance to the company. A company may, however, still submit a board analysis for the Staff's consideration if it believes it will help the Staff analyze the no-action request.

"Substantial Implementation," "Duplication" and "Resubmissions"

On July 13, 2022, the SEC proposed amendments to Rule 14a-8, which would revise three of the potential bases for a company's exclusion of a Rule 14a-8 shareholder proposal – Rule 14a-8(i)(10) (substantial implementation), Rule 14a-8(i)(11) (duplication) and Rule 14a-8(i)(12) (resubmissions). The amendments were intended to "improve the shareholder proposal process and promote consistency." The proposed amendments could have created confusion and posed a greater challenge for companies seeking to exclude shareholder proposals under these rule exclusions. The proposed amendments were never adopted, and SLB 14M makes clear that unless and until the SEC adopts or otherwise amends Rule 14a-8, the Staff will consider no-action requests and supplemental correspondence in accordance with operative SEC rules and Staff guidance.

Procedural Matters and Bases for Exclusion

SLB 14M also addresses certain procedural exclusion matters discussed below.

Use of Graphics/ Images

SLB 14M notes that the fact that the Rule 14a-8(d) “500 words” limit on proposal lengths does not expressly reference the use of graphics or images does not mean that using graphics or images in proposals is prohibited. Rather, exclusion would be appropriate under Rule 14a-8(d) if the total number of words in a proposal, including words in the graphics/ images, exceeds 500. Proposals may also be excluded under Rule 14a-8(i)(3) where, for example, graphics/ images are materially false or misleading, vague, or impugn character or personal reputation without factual foundation.

Proof of Ownership

SLB 14M makes clear that companies should not apply an overly technical reading to proof of ownership letters, or otherwise seek to exclude a shareholder proposal based on drafting variances in the proof of ownership letter, if the language used in such letter is clear and sufficiently evidences the requisite minimum ownership requirements. SLB 14M also notes the Staff’s view that Rule 14a-8 does not require a company to send a second deficiency notice to a proponent if the company previously sent an adequate deficiency notice prior to receiving the proponent’s proof of ownership and the company believes that the proponent’s proof of ownership letter contains a defect.

Use of Emails

As email use has become more prevalent among both proponents and companies alike, the Staff suggests proponents and companies use electronic means that provide for proof of delivery and confirmation of receipt when, for example, making submissions, delivering notices of defect, or submitting responses to notices of defect. In such instances, the parties should seek a reply email from the recipient acknowledging receipt and to prove timely delivery.

Key Takeaways

- **Enhanced Focus on Company-Specific Analysis.** SLB 14M returns to a focus of establishing a nexus between the social policy raised in a shareholder proposal and a company’s business. As a result, a proposal must do more than raise a broad significant social policy issue; rather, there must be a sufficient nexus between the social policy issue and the company’s business in order to survive a request for exclusion. In addition, the broadening of the “micromanagement” exclusion under Rule 14a-8(i)(7) means that climate proposals that seek to impose specific time frames or methods for GHG emissions reductions, for example, may once again be excludable.

- **Distinct Analytical Framework for Economic Relevance and Ordinary Business Exclusions.** SLB 14M clarifies that the economic relevance analysis under Rule 14a-8(i)(5) should be distinct from the ordinary business exclusion under Rule 14a-8(i)(7). The “economic relevance” exclusion under Rule 14a-8(i)(5) will now become a viable basis for exclusion on its own and no longer be tied to the availability or unavailability of the “ordinary business” exclusion under Rule 14a-8(i)(7). Companies should consider whether an argument should be made in a new or pending request, to determine whether there is a viable exclusionary argument to be made under Rule 14a-8(i)(5) for those proposals not “otherwise significantly related to the company’s business,”

- **SLB 14M Transition Application.**
  - **Companies that have already submitted no-action requests.** Companies should review pending no-action requests to determine if a new or supplemental argument should be made pursuant to Rules 14a-8(i)(5) and 14a-8(i)(7) when seeking exclusion of shareholder proposals that relate to the guidance provided in SLB 14M. The Staff stated in SLB 14M that it will consider the guidance in place at the time it issues a response, meaning that pending no-action

requests will be evaluated under the SLB 14M framework.

Should companies or proponents wish to raise new legal arguments in light of SLB 14M, they are encouraged to submit supplemental correspondence via the online portal as soon as possible. So far during the 2024-2025 proxy season, 249 companies have submitted no-action requests between December 1, 2024, and February 16, 2025, and the Staff has issued responses to 67 of these no-action requests.

- **Companies that have not submitted no-action requests.** Companies may submit new no-action requests even if the deadline prescribed in Rule 14a-8(j) has passed if they demonstrate "good cause" for missing the deadline. The Staff will consider the publication of SLB 14M to be "good cause" if it relates to legal arguments made by the new request.

For those companies that have not yet submitted no-action requests, even if their deadline to submit a request has passed, consideration should be given as to whether there are valid exclusionary arguments to be made in response to the SLB 14M guidance, particularly for those proposals that relate to environmental or social concerns.

Non-Competes: One Step Forward and Two Steps Back

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In 2024, two federal agencies saw challenges to their regulations restricting non-compete agreements, while several states enhanced restrictions or proposed amendments expanding existing non-compete laws.

The scope and impact of these developments are likely to be further clarified as legislation and new case law develops.

FTC Rule

In early 2024, the Federal Trade Commission (FTC) issued a final rule banning most existing and new non-competes, broadly including any covenant or mix of covenants that "function to prevent a worker from joining a competitor."[1] The rule covered all U.S. employees, including senior executives, with exceptions for (i) non-competes entered into in connection with the bona fide sale of a business; (ii) existing non-competes with senior executives, defined as workers in a "policy-making position" who earn more than $151,164 annually; and (iii) contracts between a franchisee and a franchisor. The rule also required that employers provide notice to workers who are subject to a non-compete provision that the non-compete will not and cannot legally be enforced against them.

Although the rule's scheduled effective date was September 4, 2024, it faced many legal challenges and, on August 20, 2024, was vacated by a federal court in Texas on a nationwide basis. The FTC challenged that decision in a notice of appeal on October 18, 2024,[2] and the FTC also defended the rule in an Eleventh Circuit appeal on November 4, 2024.[3] Further challenges are likely to be seen in 2025, and we anticipate it will be some time until final decisions are rendered by the courts. For now, the rule remains vacated and state law currently controls the applicability of any non-compete and other restrictive covenants.

NLRB Enforcement

The National Labor Relations Board's (NLRB's) May 2023 memorandum stating that most non-compete agreements violate the National Labor Relations Act has spurred a number of enforcement actions, one of which has altered the framework the NLRB utilizes to assess the validity of restrictive covenants. In August 2023, the NLRB decided to adopt a new burden-shifting framework for restrictive covenants that requires evaluating whether a facially neutral work rule or policy could reasonably be interpreted to be coercive "from the perspective of an employee who is subject to the [challenged] rule and economically dependent on the employer."[4] If that burden is met, the NLRB will find the rule presumptively unlawful, though the presumption can be rebutted by the employer with adequate evidence.

The framework has been used in subsequent cases, one of which involved rescinding non-compete provisions in an employment agreement on the grounds that they chilled union-organizing activity.[5] In the case, an employee who engaged in "salting," a practice that involves taking a non-union job intending to organize a workforce, was discharged by their employer.

The challenged non-compete provisions prohibited employees from soliciting or persuading other employees of the employer to leave their employment and engaging or working in any other similar or competitive businesses following their separation from the employer. The

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provisions also required the employee to report any solicitation offers they received. In June of 2024, the NLRB found these provisions to be in violation of the National Labor Relations Act and ordered their recission.

State Developments

Restrictions on non-compete clauses have also been developing rapidly at the state level. Currently, total bans on non-competes are in effect in California (whose retroactive notice requirement went into effect on January 1, 2024, with a deadline for compliance shortly thereafter), North Dakota, Oklahoma and, most recently, Minnesota.

Building on its existing non-compete ban, the Minnesota House proposed a bill, HF 3456, that would apply to service providers and prohibit restrictive covenants in service contracts, intending to close a loophole in its current non-compete ban that allows service providers to subject employees to non-solicit and no-hire restrictions through intercompany contracts. This bill was scheduled for further action in the Minnesota House on March 7, 2024, but thus far no further action has been taken.

In Delaware, a January 2024 ruling by the Delaware Supreme Court reversed a previous decision by the Court of Chancery and upheld the enforceability of restrictive covenants in partnership agreements, which conditioned distributions on partners' compliance with non-compete and non-solicit provisions.[6] As the subsequent application of this case has created some ambiguity for courts reviewing provisions governed by Delaware law, the Seventh Circuit recently certified two questions to the Delaware Supreme Court about the scope of the ruling, for which arguments were heard on October 9, 2024.

In Massachusetts, *Miele v. Foundation Medicine Inc.*, a case decided this past July, clarified that the Massachusetts Noncompetition Act (MNAA) does not apply retroactively from its effective date of October 1, 2018, though the court held that reaffirmation of an existing agreement creates a new agreement for purposes of the effective date. The court also held that forfeiture-for-competition provisions, which are covered under the MNAA, include non-solicits and no-recruit covenants. On November 4, 2024, the defendant filed its opening brief in an application for direct appellate review.

Finally, Washington amended its non-compete laws with Senate Bill 5935 (S.B. 5935), effective June 6, 2024, which expanded the definition of "non-competition covenant" to include agreements that directly or indirectly prohibit the acceptance or transaction of business with a customer. Employers should be focused on a few key aspects of the amendments, namely that employers must disclose non-competition covenants to prospective employees by the time of an employee's initial acceptance of an employment offer, regardless of whether the offer is oral or written. Additionally, the amendment clarified that a person aggrieved by a noncompetition covenant, regardless of whether or not they were a party to the covenant, can pursue relief.

Next Steps

As an ongoing matter, employers should catalog where employees are located and be prepared to track both current and former employee mobility to ensure compliance with non-compete restrictions, review and revise form agreements for any potentially void non-compete clauses and continue to consult with counsel and monitor these and other developments over the coming year.

Notes

1. FTC, "FTC Announces Rule Banning Noncompetes" (April 23, 2024), available here.

2. *See Ryan, LLC v. Federal Trade Commission* (N.D. Tex. August 20, 2024).

3. *See Properties of the Villages Inc. v. Federal Trade Commission* (M.D. Fla. August 15, 2024).

4. NLRB Office of Public Affairs, "Board Adopts New Standard for Assessing Lawfulness of Work Rules" (August 2, 2023), available here.

5. *See J.O. Mory, Inc. and Indiana State Pipe Trades Ass'n a/w United Assn. of Journeymen and Apprentices of the Plumbing and Pipefitting Indus. Of the United States and Can., AFL-CIO* (June 13, 2024).

6. *See Cantor Fitzgerald, L.P. v. Ainslie*, C.A. No. 9436 (Del. January 29, 2024).

An Active Year in Enforcement, with Changes to Come

By David A. Last, Lisa Vicens, Matthew C. Solomon, Tom Bednar, and Ava Bayani Kazerouni

The SEC's aggressive focus on crypto enforcement continued, resulting in the filing and continued litigation of several cases in federal courts nationwide. The DOJ announced a number of policy updates in 2024, including guidance related to voluntary disclosures and corporate enforcement, and remained active in the foreign corruption and national security spaces.

Finally, both the SEC and DOJ have increased their focus on AI and new technologies, showing increasing concern about the risks associated with AI, with the DOJ issuing guidance on AI in compliance programs and the SEC bringing cases related to misleading marketing about the use of AI in investment strategies. As noted more fully below, with the incoming Trump Administration, enforcement priorities at both SEC and DOJ are expected to shift.

The SEC is expected to have a renewed focus on traditional enforcement areas, such as accounting fraud, misrepresentations in securities offerings and insider trading, with significant reductions in enforcement activity related to crypto, cyber incidents, and ESG issues. The DOJ is likely to continue its focus on FCPA and national security (including sanctions and export controls), while devoting increasing resources to immigration and violent crime. Additionally, the benefits of cooperation are likely to increase at both the SEC and DOJ, with the potential for reduced penalties for companies able to effectively demonstrate their cooperation and self-remediation.

In anticipation of the incoming Trump Administration, there already have been notable personnel changes at both SEC and DOJ with more to come. Specifically, SEC Chair Gary Gensler and Democratic Commissioner Jaime Lizarraga have announced that they will depart. In addition, Trump has announced the nomination of former Commissioner Paul Atkins as Chair, who will stand to replace the outgoing heads of the Divisions of Enforcement and Corporation Finance, among other positions.

On the DOJ side, Attorney General-nominee Pam Bondi and Deputy Attorney General nominee Todd Blanche will work with all-new appointees at the top levels of DOJ. Most of the nominees for those positions have yet to be announced, though the incoming administration has announced the nomination of Gail Slater to head the Antitrust Division and Kash Patel to run the FBI.

Key SEC Developments

The SEC filed 583 total enforcement actions in 2024, a 26% decline from the previous year.[1] Total financial remedies reached $8.2 billion, the highest amount in SEC history and a large increase from the $4.9 billion received in 2023, though more than half that total was attributable to a judgment obtained after the SEC's jury trial win against blockchain startup Terraform Labs and its founder, Do Kwon.[2] The SEC also continued setting records with its whistleblower program, receiving more than 24,000 whistleblower tips and announcing whistleblower awards of more than $255 million.[3]

In announcing their year-end results, the SEC highlighted the importance of self-reporting, noting that "market participants across the spectrum – from public companies to major broker-dealers and advisory firms–stepped up efforts to self-report, remediate, and meaningfully cooperate with our investigations."[4] The SEC also extolled the virtues of cooperation and remediation by entities facing enforcement

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investigations, with benefits including reduced or no penalties. The benefits of cooperation are likely to increase under the new administration. Substantively, the SEC maintained its focus on digital assets and traditional areas such as accounting, financial disclosure, and oversight of investment advisers and other regulated entities.

Artificial Intelligence

The SEC's ramp-up of AI oversight included enforcement actions, new examination priorities, and proposed rulemaking. For example, in March 2024, the SEC announced two enforcement actions against investment advisers for "AI-washing" and violations of the Marketing Rule, alleging that the relevant investment advisers had marketed that they were using AI in certain ways that they allegedly were not.

Digital Assets

Digital assets remained at the forefront of the SEC enforcement agenda, with the agency continuing to bring litigated cases rather than to pursue rulemaking. The SEC continued high-profile litigation cases against three digital asset trading platforms, which are set to extend into 2025.[5] The cases were brought in three different jurisdictions, with the courts so far agreeing only that the digital assets themselves are not securities and that the manner in which the digital asset is sold determines whether there is a securities transaction.[6] After focusing on digital asset issuers and platforms, the SEC for the first time targeted a market maker in connection with its role in facilitating the trading of digital assets.

The industry will be paying close attention to these cases that target digital asset infrastructure in the next year. With the nomination of Paul Atkins as Chair, the SEC may take a more restrained approach to digital asset enforcement by turning back to potential rulemaking, if enabled by Congress, instead of litigation, to address this new technology. As such, the SEC is expected to bring fewer cases in this space, likely only where there is potential fraud in the offering of a digital asset. With respect to ongoing litigation, where there is no allegation of fraud or investor harm, the SEC is likely to look for easy settlements or will potentially dismiss cases.

Off-Channel Communications

The SEC continued its sweep of regulated entities' use of "off-channel communications," assessing over $600 million in penalties in settled actions against over 70 broker-dealers, investment advisors, municipal advisors, and credit-rating agencies that allegedly did not comply with recordkeeping requirements in connection with employees' use of texting or messaging apps.[7]

This initiative has likely run its course, as the two Republican Commissioners who will remain on the SEC have called on the agency to "reconsider [the] current approach to the off-channel communications issue."[8] More generally, we expect the SEC likely will conduct fewer sweeps designed to condition the behavior of the securities industry and instead focus more of its resources on cases that involve actual investor harm, such as offering frauds, accounting and issuer disclosure fraud, and misappropriation of funds by investment advisers.

Cybersecurity

Cybersecurity has risen to the top of the SEC's list of enforcement priorities. In late 2023, the SEC's new rules on cyber disclosures took effect, which, among other things, require disclosure on Item 1.05 of Form 8-K within four business days after a registrant determines that it has experienced a material cybersecurity incident.[9]

While the SEC has continued to bring settled cases in this space, it was dealt a significant setback when a court dismissed most SEC fraud

claims related to allegedly misleading statements by the software company SolarWinds and its chief information security officer in connection with a massive, state-sponsored cyber intrusion the company suffered.[10] A judge in the Southern District of New York held that most of the company's statements about its cybersecurity defenses were too generalized to be materially misleading and that the internal controls provisions of the securities laws were meant to apply to accounting controls rather than cybersecurity controls. The court did, however, allow the SEC to proceed on claims that SolarWinds allegedly misled investors by posting a "security statement" on its website that touted its adherence to specific cybersecurity standards that, in the SEC's view, it was not following.

The SolarWinds case, which led to a sweep-style investigation of companies impacted by the breach, symbolized the priority the SEC attached to detailed disclosures of the potential impact of cyber incidents, as demonstrated by multiple enforcement actions in the last several years against companies that were themselves the victims of cyber attacks.

In the wake of the court ruling, as well as statements by the Republican commissioners who objected to bringing the SolarWinds case and similar cases targeting victims of cyber-attacks, the SEC is likely to temper its backward-looking scrutiny of companies' post-incident disclosures and refrain from charging internal controls violations in cybersecurity cases where the company's accounting and disclosure controls are not specifically implicated.[11]

Key DOJ Developments

In 2024, the DOJ published a number of policy updates and guidance in areas related to corporate enforcement, compliance, and the use of AI. This focus was similarly reflected in the hiring of personnel, such as the department's first Chief Science and Technology Advisor and Chief Artificial Intelligence Officer.[12] Through these policies, the DOJ continued its strategy of incentivizing voluntary self-disclosure by providing specific and quantifiable benefits for self-reporting, including by rolling out a new whistleblower awards pilot program offering bounty payments to individual whistleblowers.

The incoming Trump Administration will want to make their imprint through their own DOJ policies, as such we may expect them to withdraw or revise policies that raise the bar on what is required for companies to receive leniency, while keeping in place policies that benefit corporate defendants.[13] In 2024, the DOJ remained focused on corporate enforcement in areas such as FCPA, anti-money laundering, digital assets, and, increasingly, on national security, which is likely to continue with the incoming Trump Administration.

Policy Updates and Guidance

The DOJ issued a number of important policy updates and guidance throughout 2024, with a continued focus on voluntary self-disclosure and ratcheting up pressure on companies to be "first in the door" to self-report misconduct. The DOJ policies seek to achieve this objective by rewarding whistleblowers with monetary awards; offering non-prosecution agreements to culpable individuals who provide actionable information; providing safe harbor for acquiring companies who self-report criminal conduct by an acquired company; and a continued emphasis on maintaining an effective compliance program. These policies are:

- **Mergers & Acquisitions Safe Harbor:** In another iteration of its emphasis on self-reporting, the DOJ revised the Justice Manual to include a "safe harbor" from prosecution for acquiring companies that self-report criminal conduct by an acquired company identified in due diligence. The Safe Harbor, implemented in March 2024, provides a presumption in favor of DOJ declining to prosecute an acquiring company that voluntarily and promptly self-reports criminal violations by an acquired company, remediates any

misconduct and forfeits proceeds of the violation.[14] However, additional requirements apply to potential criminal Sherman Act violations.

The Safe Harbor provision does not permit compliant companies that report criminal violations of the Sherman Act by a target to close their acquisition until the DOJ Antitrust Division provides a conditional leniency letter or allows the leniency marker to expire, making it an impractical option for the majority of purchasers.[15]

- **The Pilot Program on Voluntary Self-Disclosure for Individuals:** In April, the DOJ launched a Pilot Program on Voluntary Self-Disclosure for Individuals to incentivize culpable individuals to self-report their misconduct and cooperate in the DOJ's investigation and prosecution of other individuals and companies in exchange for non-prosecution agreements (NPAs).[16] Culpable individuals can qualify for an NPA if they are first to report and provide substantial assistance to the prosecution of more culpable individuals or companies in certain core enforcement areas.[17]

The DOJ programs effectively create a race between companies and individuals to report misconduct, as an individual must be "first in the door" in order to receive an NPA or whistleblower award.[18] This likely will leave companies at a disadvantage as it is often easier for individuals to have an understanding of their role in misconduct as compared to companies, especially large, multinational companies. As culpable individuals may be incentivized to report directly to DOJ, companies will need to balance conducting thorough, confidential and complete internal investigations with maintaining confidentiality so as not to "tip off" individuals involved in the misconduct. As the whistleblower and individual self-disclosure programs are pilot programs, it is possible the Trump Administration will not renew them.

- **Whistleblower Awards Pilot Program:** The DOJ's Whistleblower Awards Pilot Program, launched last August, provides individuals with awards of up to $50 million if they provide original information and cooperate in an investigation leading to more than $1 million in criminal or civil forfeiture in connection with a successful DOJ case related to corporate criminal conduct.[19]

Notably, companies that receive internal whistleblower reports are still eligible to obtain credit and the presumption of a declination even if the whistleblower also reported to DOJ, so long as the company (1) self-discloses the allegation to DOJ within 120 days of receiving the whistleblower's internal report (and before the DOJ contacts the company); and (2) meets the other requirements for voluntary self-disclosure and presumption of a declination under the Corporate Enforcement and Voluntary Self-Disclosure Policy.[20]

- **Revisions to the DOJ Criminal Division's Compliance Guidance (ECCP):** In September 2024, DOJ announced revisions to the Criminal Division's compliance guidance, known as the Evaluation of Corporate Compliance Programs (ECCP).[21] With respect to new AI, the updated guidance reflects efforts to analyze how companies are using new technologies in their businesses, and whether that use is accompanied by an appropriate assessment of the potential risks and vulnerabilities that those technologies may present.[22] The revised ECCP additionally emphasized the importance of companies having processes in place to periodically evaluate their own compliance programs, focusing on continuous improvement through the leveraging of data and analytics tools.[23]

Furthermore, DOJ will expect companies to incorporate lessons learned from both their own prior misconduct and from issues at other companies into their compliance programs through trainings that are regularly

updated and also to focus on evolving risks for the company and the industry in which it operates. Finally, the ECCP incorporated changes related to whistleblower reporting, emphasizing that prosecutors will assess whether companies are promoting whistleblower reports and are assessing employee willingness to report misconduct, such as testing whether employees are aware of and feel comfortable using reporting hotlines.[24]

FCPA

Enforcement of the Foreign Corrupt Practices Act (FCPA) remained a priority in 2024, with the DOJ entering into eight corporate criminal resolutions and issuing one declination under the Criminal Division's Corporate Enforcement and Voluntary Self-Disclosure Policy, which was revised in 2023.[25] The DOJ's actions reflect the continued premium placed on voluntary self-disclosure, as well as proactive and full cooperation.

To merit a declination, the DOJ has emphasized the timeliness of the disclosure following the discovery of evidence, as well as the full cooperation and remediation by the company, which included termination of responsible personnel and disgorgement of all ill-gotten gains.[26] The DOJ also continued its increasing cooperation with international authorities, including its first coordinated resolution with Ecuador, two additional resolutions coordinated with South Africa, and continued cooperation with authorities from Brazil, Switzerland, Uruguay, Colombia, Singapore, Portugal, and elsewhere.[27]

DOJ also continued securing trial convictions and guilty pleas in a number of significant, high-profile foreign bribery matters in multiple jurisdictions. Among others, the DOJ successfully convicted the former Comptroller General of Ecuador and the former Finance Minister of Mozambique following lengthy trials in Miami and Brooklyn.[28] In addition, DOJ obtained trial convictions in two cases involving former commodities trading executives Javier Aguilar and Glenn Oztemel.[29]

Both trials highlighted DOJ's ability to secure and present the testimony of cooperators who plead guilty and testify against their former coconspirators, providing detailed accounts of the bribery schemes. The Aguilar trial included testimony from 10 cooperating witnesses, including the former officials who were bribed, the intermediaries who facilitated the bribe payments, and others.[30] Given these recent successes, DOJ is likely to remain focused on charging individuals in foreign bribery cases.

In addition, the Foreign Extortion Prevention Act (FEPA) was signed into law in December 2023 and amended in July 2024.[31] The FEPA provides a mechanism for U.S. authorities to prosecute the demand side of foreign corruption, and was amended to clarify key jurisdictional hooks as well as the individuals to whom the FEPA applies, in effect harmonizing the law with the FCPA.[32]

The focus on the FCPA and FEPA signals that anti-corruption enforcement is likely to remain active with the incoming administration. FCPA enforcement remained strong under the last Trump Administration and we would expect continued robust enforcement, though the benefits may be even higher for companies that know how to demonstrate that they had strong compliance programs in place.

Digital Assets

Prosecutions related to giants in the digital asset space continued in 2024. The global cryptocurrency exchange BitMEX, for example, pled guilty in July 2024 to violations of the Bank Secrecy Act by failing to establish, implement and maintain an adequate anti-money laundering program.[33] Furthermore, 18 individuals and entities serving as or at cryptocurrency financial services firms were charged in October 2024 for widespread fraud and manipulation in the cryptocurrency markets.[34]

In addition, sentences have been handed down related to the breakdown of the FTX exchange, with founder Sam Bankman-Fried sentenced to 25 years in prison and coconspirator sentences ranging from supervised release to seven and a half years in prison.[35]

Financial Institutions

Anti-money laundering enforcement remained strong, with the 10th largest bank in the U.S. pleading guilty and agreeing to pay over $1.8 billion in penalties as a result of the DOJ's investigation into violations of the Bank Secrecy Act and money laundering, marking the first time a U.S. bank pled guilty to conspiracy to commit money laundering.[36] The plea agreement evidences the DOJ's focus on strong compliance programs within the financial institution space.

National Security and Export Controls

In recent years, the DOJ has taken up a renewed focus on national security, sanctions, and export controls matters. Beginning in 2022, following Russia's invasion of Ukraine, the DOJ signaled an increased commitment to sanctions enforcement, referring to it as "the new FCPA" in terms of prioritization.[37] In March 2024, Assistant Attorney General Matthew G. Olsen stated that "the National Security Division [will] now interact with corporations and the business community like never before" in this space.[38]

In pursuit of such efforts, the DOJ more than doubled the number of prosecutors working on sanctions, export control, and foreign agent registration cases.[39] In May 2024, the National Security Division issued its first declination, to a company that voluntarily disclosed a former employee's scheme to illegally export products to China.[40] As part of its decision not to prosecute, the DOJ cited the timely and voluntary self-disclosure, which came only one week after retaining outside counsel to conduct an internal investigation, as well as the lack of a significant threat to national security posed by the activity and the fact that the company made no unlawful gains from the offense.[41]

The DOJ also focused on individual prosecutions under the Foreign Agents Registration Act (FARA), bringing charges against a number of individuals, notably including U.S. Senator Robert Menendez, former New York State official Linda Sun and U.S. Congressman Enrique Roberto "Henry" Cuellar in 2024.[42] Under the Trump Administration, national security is expected to remain a DOJ priority.

Key Takeaways

Following the election, enforcement priorities are likely to shift at both the DOJ and SEC. Based on the last Trump Administration and stated policy preferences, we can predict some priorities:

- The SEC will likely return to more traditional, bread and butter cases that involve harm to retail investors, such as accounting and disclosure fraud, misappropriation of funds by investment advisers, market manipulation and insider trading, and offering frauds. On the other hand, there likely will be a decrease in enforcement activity related to ESG, cybersecurity, off-channel communications, and crypto, which were a focus of the SEC under Gensler and the Biden Administration.

- The SEC will levy smaller penalties on large entities, and penalties will need to bear a relation to a measurable benefit the entity received from its alleged securities law violations. The SEC will be less likely to pursue novel theories of disgorgement. The returns on cooperation are likely to be even greater than before, with companies that cooperate with investigations and self-remediate standing to benefit more tangibly than in the past.

- The SEC likely will take a less expansive approach to materiality, will focus more on issuer disclosures directly linked to financial results and less on cyber or ESG issues, and will be less likely to pursue aggressive theories and perceived "regulation by enforcement." With resource constraints likely to continue, the SEC may also shy away from pursuing protracted litigation where they are not assured of success. With the SEC more receptive to the arguments made by public companies and regulated entities, effective, thoughtful advocacy will matter more than ever.

- Under the Trump Administration, some areas of white-collar enforcement will continue as priorities or even increase, while others will decline. There is likely to remain a strong focus on FCPA enforcement, which increased during the first Trump Administration. In addition, there is likely to be a continued focus on national security and sanctions/export controls, another area that showed significant activity during the previous Trump Administration. On the other hand, there may be decreased activity in traditional business crimes and in the environmental space. There also likely will be lower penalties and fewer monitorships going forward.

- Most DOJ policies are likely to remain in place, including with respect to corporate compliance and cooperation. Indeed, there may be more potential for reduced penalties or declinations for companies that can point to effective compliance programs, internal investigations, and self-remediation in the wake of alleged misconduct.

  As such, companies should pay particular attention to the state of their compliance programs and ensure that they have engaged in periodic assessments and evaluations of their overall effectiveness, with an emphasis on internal reporting mechanisms, regularly updated trainings and the efficient processing and prioritization of whistleblower complaints. Furthermore, companies should invest in the use of new technologies, as well as data and data analytics tools to enhance their compliance programs, as well as ensure that adequate safeguards are in place to monitor those new technologies.

Notes

1. SEC Press Release, "SEC Announces Enforcement Results for Fiscal Year 2024," (November 22, 2024)(SEC Year in Review).

2. *Id.*; SEC Press Release, "Terraform and Kwon to Pay $4.5 Billion Following Fraud Verdict," (July 2, 2024).

3. SEC Year in Review, *supra* note 1.

4. *Id.*

5. SEC Press Release, "SEC Files 13 Charges Against Binance Entities and Founder Changpeng Zhao," (June 5, 2023); SEC Press release, "SEC Charges Coinbase for Operating as an Unregistered Securities Exchange, Broker, and Clearing Agency," (June 6, 2023); SEC Press Release, "SEC Charges Kraken for Operating as an Unregistered Securities Exchange, Broker, Dealer, and Clearing Agency," (November 21, 2023).

6. This approach was first devised by the court in 2023 in an SEC litigation against crypto and blockchain technology company, Ripple Labs Inc., its CEO Brad Garlinghouse and its former CEO and Executive Chairman Christian Larsen.

7. SEC Year in Review, *supra* note 1.

8. SEC Statement, "A Catalyst: Statement on Qatalyst Partners LP," (September 24, 2024).

9. SEC Statement, "Cybersecurity Disclosure," (December 14, 2023).

10. For more information on the SDNY Court's Dismissal of SEC Claims Against SolarWinds and CISO, *see* our July blog post available at *https://www.clearygottlieb.com/news-and-insights/publication-listing/sdny-court-dismisses-several-sec-claims-against-solarwinds-and-its-ciso*.

11. The Republican commissioners also dissented from four cases brought in the Fall, which claimed that IT companies victimized by the SolarWinds cyber intrusion had misleadingly downplayed the incident in their disclosures.

12. DOJ Press Release, "Attorney General Merrick B. Garland Designates Jonathan Mayer to Serve as the Justice Department's First Chief Science and Technology Advisor and Chief AI Officer," (February 22, 2024).

13. This was the case in the prior Trump Administration, where, for example, they withdrew the Yates Memo, which focused on individual accountability for corporate misconduct, as well as revised the guidance on monitorships to clarify that the DOJ would appoint a monitor in

connection with a resolution only in limited circumstances where there was a "demonstrable need."

14. Justice Manual §§ 9-28.900(A)(3)(a)(i), 9-28.900(B); §§ 703.300, 9.28.900(A)(3)(c) (March 2024).

15. For more information on the Safe Harbor, *see* our March blog post available at *https://www.clearygottlieb.com/news-and-insights/publication-listing/merger-safe-harbor-for-sherman-act-violations-punishes-innocent-acquirors*.

16. The program applies broadly to all corporate misconduct, but specifically identifies certain high priority enforcement areas, including schemes involving financial institutions and the integrity of financial markets; FCPA and FEPA; health care fraud and kickback schemes; federal contract fraud schemes; and domestic corruption schemes. Certain exclusions apply, such as for a tipster who was a CEO, a CFO, or a leader of the scheme; where the tipster has a prior fraud conviction; or where the offense involves crimes of violence. DOJ, "The Criminal Division's Pilot Program on Voluntary Self-Disclosures for Individuals" (April 15, 2024).

17. *Id.* at 2-3.

18. DOJ Blogpost, "Criminal Division's Voluntary Self-Disclosures Pilot Program for Individuals" (April 22, 2024).

19. The amount of the awards will be based on the "net proceeds forfeited," which is the value of forfeited assets remaining after compensating victims and paying other costs associated with the forfeiture. Eligible whistleblowers may receive up to 30% of the first $100 million in net proceeds forfeited, and up to 5% of any net proceeds forfeited between $100 million and $500 million. DOJ Fact Sheet, "U.S. Department of Justice Corporate Whistleblower Awards Pilot Program" (August 1, 2024).

20. DOJ Temporary Amendment, "Department of Justice Temporary Amendment to Criminal Division Corporate Enforcement and Voluntary Self-Disclosure Policy" (August 1, 2024).

21. Argentieri Speech, "Principal Deputy Assistant Attorney General Nicole M. Argentieri Delivers Remarks at the Society of Corporate Compliance and Ethics 23rd Annual Compliance & Ethics Institute," (September 23, 2024).

22. DOJ, "The U.S. Department of Justice Criminal Division Evaluation of Corporate Compliance Programs" (September 23, 2024).

23. *Id.*

24. *Id.*

25. Related Enforcement Actions: 2024, U.S. DEP'T of JUSTICE; In re: Boston Consulting Group, Inc. (CEP Declination Letter) (August 27, 2024).

26. *Id.*

27. DOJ Press Release, "Swiss Commodities Trading Company Please Guilty to Foreign Bribery Scheme," (Mar. 28, 2024); DOJ Press Release, "Commodities Trading Company Will Pay Over $661M to Resolve Foreign Bribery Case," (March 1, 2024); DOJ Press Release, "SAP to Pay Over $220M to Resolve Foreign Bribery Investigations," (January 10, 2024).

28. DOJ Press Release, "Former Comptroller General of Ecuador Sentenced in International Bribery and Money Laundering Scheme," (October 1, 2024); DOJ Press Release, "Former Finance Minister of Mozambique Convicted of $2B Fraud and Money Laundering Scheme," (August 8, 2024).

29. DOJ Press Release, "Oil and Gas Trader Convicted for Role in Foreign Bribery and Money Laundering Scheme," (February 23, 2024); Press Release, "Former Connecticut-Based Energy Trader Convicted of International Bribery Scheme," (September 26, 2024).

30. DOJ Press Release, "Ex-Energy Trader for Vitol Convicted of Foreign Bribery and Money Laundering Scheme," (February 23, 2024).

31. U.S. Congress Bill, "Foreign Extortion Prevention Technical Corrections Act", S. 4548, 118th Cong. (2023).

32. *Id.*

33. DOJ Press Release, "Global Cryptocurrency Exchange BitMEX Pleads Guilty To Bank Secrecy Act Offense," (July 10, 2024).

34. DOJ Press Release, "Eighteen Individuals and Entities Charged in International Operation Targeting Widespread Fraud and Manipulation in the Cryptocurrency Markets," (October 9, 2024).

35. DOJ Press Release, "Samuel Bankman-Fried Sentenced to 25 Years for His Orchestration of Multiple Fraudulent Schemes" (March 28, 2024); Reuters, "Bankman-Fried's ex-deputy Wang avoids prison time over crypto fraud," Reuters, (November 20, 2024); DOJ Press Release, "Former FTX Executive Ryan Salame Sentenced to 90 Months in Prison," (May 28, 2024).

36. DOJ Press Release, "TD Bank Pleads Guilty to Bank Secrecy Act and Money Laundering Conspiracy Violations in $1.8B Resolution," (October 10, 2024).

37. Monaco Speech, "Deputy Attorney General Lisa O. Monaco Delivers Keynote Remarks at 2022 GIR Live: Women in Investigations," (June 16, 2022).

38. Olsen Speech, "Assistant Attorney General Matthew G. Olsen Delivers Keynote Speech at the American Bar Association's 39th National Institute on White Collar Crime," (March 8, 2024).

39. *Id.*

40. In re Sigma-Aldrich, Inc., d/b/a MilliporeSigma, (Declination) (May 14, 2024).

41. *Id.*

42. DOJ, Foreign Agents Registration Act: Recent Cases.

EU Omnibus Proposals: Key Impacts on CSRD, CSDDD, Taxonomy Regulation and CBAM

By Leah Malone, Matt Feehily, Emily Holland, Seungyeon Anderson, Alexis Capati, and Chayla Sherrod

In February 2025, the European Commission released a highly anticipated "omnibus simplification package" in response to concerns that the burden of sustainability reporting requirements has created a competitive disadvantage for European companies and the EU economy. The proposals seek to significantly reduce the scope and substance of the existing regimes, and would amend rules introduced under the EU's Corporate Sustainability Reporting Directive (CSRD), Corporate Sustainability Due Diligence Directive (CSDDD), Taxonomy Regulation, and Carbon Border Adjustment Mechanism (CBAM), as well as the InvestEU and European Fund for Strategic Investment (EFSI) Regulations.

The proposals have been welcomed by certain segments of the international business community as a reduction in "red-tape," while many others have expressed concerns that the proposed changes, which the European Commission had previously claimed would be solely for the purposes of simplification and removing overlapping requirements, amount to a significant policy shift that could undermine the achievement of the objectives set out in the EU Green Deal.

The Commission's Omnibus package includes:

- A "stop the clock" Directive, which would delay the application of: (i) CSRD by two years for EU companies that are not yet in scope of the regime, such that the second wave of companies due to report on their 2025 financial year in 2026 will not be obliged to report information until 2028; and (ii) CSDDD by one year for the first wave of companies currently due to be subject to due diligence obligations in July 2027. The delay to the application of the Directives is intended to provide sufficient time for more substantive revisions to be agreed upon.

- A more substantive Directive to amend the scope of CSRD and to amend the substance of the due diligence obligations and associated requirements under CSDDD. The Commission estimates that their proposals will reduce the number of companies in scope of CSRD by 80% by aligning the thresholds more closely to CSDDD. The Commission is also intending to introduce delegated legislation to amend the European Sustainability Reporting Standards (ESRS).

- A draft Delegated Regulation to amend delegated acts made under the Taxonomy Regulation, including in respect of Taxonomy-alignment disclosures, which would reduce the number of required data points by around 70%, and to simplify the application of the "do no significant harm" (DNSH) test in respect of pollution prevention and control.

- A draft Regulation to introduce a new *de minimis* exemption from the CBAM Regulation that is expected to have the effect of reducing the scope of CBAM by around 90% of importers but continuing to capture around 99% of emissions associated with the import of "CBAM goods."

The Commission's proposals will be scrutinized by the European Parliament and Council which may propose amendments to the package of measures before final versions are agreed and approved. The Commission has requested that the European Parliament and Council prioritize

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their review of the "stop the clock" Directive, so as to provide certainty regarding delayed application for companies that would otherwise be obliged to publish a sustainability report under CSRD for the first time in 2026. For a more detailed discussion on anticipated timing, please *see* "Next steps" below.

Proposed Changes to CSRD

Scope and Timing

The following table summarizes the proposed changes to the scope and application of the respective CSRD reporting "waves," as well as the effect of the proposed delays to the reporting timelines.

The proposals would, in effect, replace the current staggered scoping thresholds for EU companies with a single threshold, applying to EU companies that have more than (a) 1000 employees **and** either (b)(i) turnover above €50 million **or** (b)(ii) balance sheet above €25 million. In other words, the regime will apply to "large undertakings"[1] that have more than 1000 employees, aligning more closely with the scoping thresholds for CSDDD.[2] As a result, small- and medium-sized entities (SMEs) would be scoped out of the CSRD requirements. The regime will continue to apply to parent undertakings of large groups, if the group, on a consolidated basis, also exceeds 1000 employees.

As noted above, the introduction of a requirement for large companies (or large groups) to have more than 1000 employees is expected to reduce the scope of CSRD by around 80%.

The draft text requires transposition of the "stop the clock" Directive by Member States into national law by 31 December 2025. If the two-year delay is agreed upon, this will allow more time for the EU institutions to negotiate the more substantive changes proposed by the Commission in the second Directive, including with respect to the proposal to introduce a 1000-employee threshold.

ESRS and Sector-Specific Reporting Standards

The Commission has indicated that it intends to adopt a separate delegated act to revise the current ESRS. The revisions would seek to: (i) reduce the number of mandatory ESRS data points; (ii) prioritize quantitative data points over narrative text; (iii) provide clearer instructions on how to apply the materiality principle to reduce the risk that assurance service providers inadvertently encourage undertakings to report information that is not necessary or to dedicate excessive resources to the materiality assessment process; and (iv) simplify the structure and presentation of the standards.

Contrary to rumors prior to the publication of the Omnibus proposals, the Commission is not seeking to change or remove the double materiality principle which lies at the core of CSRD, though has committed, via the revised ESRS, to provide additional instructions on how to apply the double materiality principle. Accordingly, in-scope companies will still be required to report on their impacts, as well as sustainability-related risks and opportunities.

The Commission intends to adopt the revised ESRS (which would still be subject to approval by the Parliament and the Council, albeit on the basis of a lack of objection requiring a qualified majority vote) at the latest six months after the entry into force of the substantive Directive amending CSRD and CSDDD.

In addition, to avoid increasing the number of prescribed data points, the proposals also suggest disposing with the development of sector-specific sustainability reporting standards, which were originally due for adoption in 2024, but which have already been delayed until 2026.

Assurance

Currently, CSRD requires limited assurance of reported sustainability information, and provides that the standard could, in the future, be increased to reasonable assurance.

CSRD: Summary of Changes to Scope and Timing				
Entity Cohort	**Original CSRD scope**	**Original Timing of First Sustainability Reports**	**Proposed CSRD Scope**	**Proposed Timing of First Sustainability Reports**
Wave 1 – Public Interest Entities (PIEs) and large listed companies	PIEs with more than 500 employees. Issuers with securities admitted to trading on EU-regulated markets with more than 500 employees.[3]	Report in 2025 for FY 2024	The separate category for PIEs is **deleted**, and companies will be scoped in only if they are large companies (or parent undertakings of a large group) with more than 1000 employees. PIEs with fewer than 1000 employees will be scoped out (but will still be required to report in 2025 for the FY 2024 and likely in 2026 for FY 2025). The threshold for issuers with securities admitted to trading on a regulated market is **increased** to 1000 employees. Issuers with more than 500 employees, but fewer than 1000 employees will be scoped out (but will still be required to report in 2025 for FY 2024 and likely in 2026 for FY 2025).	Reports for FY 2024 are already due to be published in 2025[4]
Wave 2 – large EU companies	EU large undertakings (and parent undertakings of large groups), defined as those exceeding at least 2 of the following thresholds: (a) balance sheet total: €25mn; (b) net turnover: €50mn; (c) employees: 250.	Report in 2026 for FY 2025	EU large undertakings (and parent undertakings of large groups) with at least 1000 employees plus at least 1 of the following thresholds: (a) balance sheet total: €25mn; (b) net turnover: €50mn. The definition of a large undertaking is unchanged, so the 1000-employee requirement means that only a subset of large undertakings would be subject to CSRD (whereas it currently applies to all large undertakings).[5]	**Delayed** – report in 2028 for FY 2027

CSRD: Summary of Changes to Scope and Timing (*Continued*)				
Entity Cohort	**Original CSRD scope**	**Original Timing of First Sustainability Reports**	**Proposed CSRD Scope**	**Proposed Timing of First Sustainability Reports**
Wave 3 – SME PIEs and listed SMEs	SMEs[6] that are PIEs or issuers and which are not micro undertakings, small and non-complex institutions, and captive insurance undertakings.	Report in 2027 for FY 2026	Removed from scope.	**N/A** if changes to scope are confirmed, otherwise, **delayed** – report in 2029 for FY 2028
Wave 4 – non-EU companies	Subsidiary undertakings[7] whose ultimate parent is a third country undertaking, or EU branches of third country undertakings where: (a) the EU subsidiary is a large company[8] or an SME which is a PIE, or, as applicable, the EU branch of the third country undertaking generates more than €40mn net turnover; and (b) the third-country undertaking, at a group level generates more than €150mn net turnover in the EU (for each of the last two consecutive financial years).	Report in 2029 for FY 2028	The EU net turnover threshold for the non-EU undertaking (or its group) is **increased** to €450mn; the threshold for the in-scope subsidiary undertaking is **increased** to align to the large undertaking thresholds (*i.e.* SME PIEs are scoped out); and the net turnover threshold for an EU branch is **increased** to €50mn.[9]	**Unchanged**

The proposals retain the requirement for limited assurance but remove the potential future uplift to reasonable assurance.

The Commission also proposes that the deadline for it to adopt [broad] standards for sustainability assurance through delegated acts, currently due by 2026, be extended indefinitely. Under the proposal, the Commission would issue targeted assurance guidelines by 2026. This change is intended to allow the Commission to more quickly address key issues that generate unnecessary burden on in-scope undertakings. In particular, it has been noted that the current approach being taken by assurance providers may, in some cases, be creating a situation of "over compliance" by in-scope companies.

Voluntary Reporting Standards and Value Chain Cap

For undertakings that will not be in scope of mandatory sustainability reporting under CSRD

(*i.e.* those with fewer than 1000 employees), the Commission proposes to adopt a delegated act introducing a voluntary sustainability reporting standard based on EFRAG's voluntary sustainability reporting standard for SMEs (VSME), which are designed to offer a more proportionate approach to reporting for smaller companies. The Commission has argued that the introduction of voluntary standards will mean that while there is an 80% reduction in the scope of CSRD, this will not equate to an 80% reduction in the number of companies reporting sustainability information.

In order to prevent larger companies from imposing burdensome reporting requirements on their smaller value chain partners, the Commission proposes to introduce a rule that would prevent in-scope companies from requesting information from their smaller value chain partners (those with fewer than 1000 employees) that goes beyond the information required under the voluntary reporting standards (the value chain cap). Nonetheless, the Commission notes, without elaborating, that in-scope undertakings would still be able to collect from such companies any additional sustainability information that is commonly shared between companies in the same sector.

Taxonomy Reporting

Under Article 8 of the Taxonomy Regulation, large undertakings in scope of CSRD are also required to disclose the extent of their "Taxonomy alignment" in relation to the Capex, Opex, and turnover, in accordance with the calculation methodologies and presentation requirements set out in the Disclosures Delegated Act. The effect of the proposed changes to the CSRD scoping would also reduce the scope of the Article 8 disclosure obligation; however, the Commission is proposing to go further by making Taxonomy disclosures voluntary even for companies with more than 1000 employees, if their net turnover does not exceed €450 million.

Noting some of the challenges companies experience in evaluating their Taxonomy alignment, the Commission is also proposing to introduce a concept of "partial Taxonomy alignment." This would allow companies to report on activities that meet just certain technical screening criteria under the Taxonomy. The intention is for reporting on partial alignment to help foster a gradual environmental transition of activities over time, in line with the aim to scale up transition finance.

Proposed Changes to CSDDD

CSDDD entered into force on 25 July 2024 and requires EU and non-EU companies to implement sustainability due diligence measures to identify and address adverse human rights and environmental impacts in their own operations, the operations of their subsidiaries, and in their chains of activities.

Scope and Timing

The Commission is not proposing to amend the scope of application of CSDDD. Accordingly, CSDDD will ultimately apply to all EU companies with more than 1000 employees, and more than €450 million in global net turnover, and to all non-EU companies generating more than €450 million net turnover in the EU.

Similar to CSRD, CSDDD is currently due to apply in three waves; however, unlike CSRD, all three waves contain scoping mechanisms that include non-EU companies, and CSDDD is intended to have direct extraterritorial effect for in-scope non-EU companies (unlike CSRD which applies the non-EU reporting requirements to an EU subsidiary or branch, rather than the non-EU parent/company directly).

The substantive due diligence obligations set out in CSDDD are set to apply from July 2027 onwards, meaning that it would require information from the first wave of companies to be reported in 2029, in respect of their 2028 financial year. Under the "stop the clock" Directive,

the Commission is proposing to delay this application by one year. The implementation deadline for EU member states would also be delayed by one year, to July 2027. There is no proposal to delay the application for the second and third waves of companies under CSDDD. The table below describes the effect of the proposed delays.

Adoption of Due Diligence Guidelines

In an effort to reduce administrative burdens on companies, the Commission proposes to bring forward its own deadline to adopt general due diligence guidelines by six months, to July 2026. This will allow two full years for the new first wave of companies (*i.e.* combining the original waves 1 and 2 above) to digest the practical guidelines prior to the application of their due diligence obligations.

Reduced Scope and Frequency of Value Chain Due Diligence

Currently, CSDDD requires value chain due diligence with respect to a company's direct and indirect business relationships. In respect of upstream value chains, this extends to "tier n" business partners. Regarding downstream value chains, CSDDD requires companies to consider participants involved in distribution, transport, or storage when done for or on behalf of the company. The Commission's proposals would limit the requirement to conduct due diligence along an undertaking's value chain to only its direct (*i.e.* "tier 1") business partners. Companies would only be required to look beyond their direct business relationships where they have "plausible information" of an objective character that suggests an adverse impact at the level of an indirect business partner. The proposals include the following examples where a company may have "plausible information": (i) a business relationship lacks economic rationale (*i.e.* where a business relationship was chosen to remove an otherwise direct supplier with harmful activities); (ii) the company has received a complaint or has received information through credible media or an NGO report; (iii) the company is aware of past incidents with an indirect supplier; and (iv) the company is aware of problems at a certain location. In addition, in-scope companies would be limited on the amount of information that they may request as part of the value chain mapping to information specified in the voluntary reporting standards under CSRD (*see* discussion above).

The proposals would reduce the frequency at which an in-scope company would be required to assess the adequacy and effectiveness of its due diligence measures from being on an annual basis to every five years.

Review Clause for Financial Services

Under CSDDD, financial services firms are only required to conduct due diligence with respect to their upstream value chains. CSDDD includes a review clause requiring the Commission to submit a report to the Parliament and Council by 26 July 2026 on the necessity of introducing additional sustainability due diligence requirements for financial undertakings. The Commission's proposals remove this review mechanism, noting that the timing of the review would not leave any time to take into account the experience with the newly established, general due diligence framework published by the Commission. As the review is removed rather than amended or delayed, this seems to suggest that the scope of due diligence for financial services would not be extended in the future.

Duty to Terminate Business Relationships

Where actual or potential impacts are identified in the value chain, CSDDD currently requires in-scope companies to terminate the business relationship as a last resort. The proposal would remove this requirement and replace it with an option to suspend the business relationship while continuing to work with the business partner toward a solution. This flexibility is introduced on the basis that companies may find themselves in situations where

Entity Cohort	CSDDD Scope	Original Timing of Due Diligence Obligations/Reports	Proposed Timing of Due Diligence Obligations/Reports
Wave 1	EU companies with more than 5000 employees and more than €1.5bn net worldwide turnover. Non-EU companies with more than €1.5bn net turnover generated in the EU.	Due diligence obligations apply from July 2027, first information to be reported in 2029 for FY 2028.	**Delayed** – Due diligence obligations apply from July 2028, first information to be reported in 2030 for FY 2029. In effect, the distinct category for Wave 1 is removed, as timing for companies in Wave 1 is collapsed into the timing for Wave 2 (*i.e.* since both waves exceed the applicable thresholds for Wave 2).
Wave 2	EU companies with more than 3000 employees and more than €900mn net worldwide turnover. Non-EU companies with more than €900mn net turnover generated in the EU.	Due diligence obligations apply from July 2028, first information to be reported in 2030 for FY 2029.	**Unchanged**
Wave 3	EU companies with more than 1000 employees and more than €450mn net worldwide turnover. Non-EU companies with more than €450mn net turnover generated in the EU. EU or non-EU companies entering into franchising or licensing agreements in the EU, with more than €22.5mn royalties and €80mn net turnover.[10]	Due diligence obligations apply from July 2029, first information to be reported in 2030 for FY 2029.	**Unchanged**

production relies heavily on inputs from one or several specific suppliers.

Stakeholder Engagement

Under the proposals, companies would only be required to engage with "relevant" stakeholders, which would include workers, their representatives including trade unions, individuals, and communities whose rights or interests are or could be directly affected by the products, services, and operations of the company, its subsidiaries and its business partners, and that have a link to the specific stage of the due diligence being carried out, for example, affected individuals when designing a remediation process and not in respect of other areas (*e.g.*, termination of business relationships).

Civil Liability

The EU-wide civil liability regime introduced by CSDDD would be removed by the proposals and CSDDD would defer to Member States on the introduction of any civil liability regime for breach of the requirements under CSDDD. This includes deletion of the current provision requiring a turnover-based pecuniary penalty, with a maximum penalty of no less than 5% of net worldwide turnover in the previous financial year.

Nonetheless, to the extent Member States introduce a civil regime, such a regime would need to ensure that where a company is held liable for damage caused to a person by failure to comply with the due diligence requirements under CSDDD, those persons have a right to full compensation.

Transition Plans

Under the proposals, the requirement to put into effect a transition plan for climate change mitigation would be replaced to clarify that the obligation to adopt a transition plan includes outlining implementing actions, planned and taken.

Harmonization

Notably, the Commission proposes to extend the scope of maximum harmonization (allowing Member States to go beyond certain CSDDD requirements through the adoption of more stringent provisions) to additional provisions of the Directive. This would prevent Member States from introducing into their national law provisions that are covered by CSDDD relating to the identification duty, the duties to address adverse impacts that have been or should have been identified, and the duty to provide for a complaints and notification mechanism.

Proposed Changes to the Taxonomy Regulation

The Taxonomy Regulation and accompanying Climate Delegated Act and Environmental Delegated Act have created a unified EU classification system to define environmentally sustainable economic activities. The Disclosures Delegated Act specifies the form and content of the disclosures that entities in scope of Article 8 of the Taxonomy Regulation must make with regards to the proportion of their activities that are Taxonomy-eligible and Taxonomy-aligned.

As part of the Omnibus package, the Commission is proposing to amend the Climate Delegated Act, the Environmental Delegated Act, and the Disclosures Delegated Act.[11]

As delegated acts (*i.e.* secondary legislation), the Commission is able to propose and adopt amendments directly (subject to non-objection by the European Parliament and the Council). As such, the proposed changes are not subject to the same hurdles as will be required for CSRD and CSDDD. The Commission has therefore published a consultation seeking feedback on a proposed delegated regulation that would amend the three acts. The consultation is open for feedback for four weeks, closing on 26 March 2025, and contains the following key proposals. The Commission has not indicated how quickly the changes would be adopted following the consultation, but this could be enacted independently of any of the other changes contemplated in the Omnibus package.

10% De Minimis *Threshold*

Financial and non-financial undertakings would not need to assess alignment with the EU Taxonomy for activities that are not financially material to their business. For these purposes, activities that constitute less than 10% of the relevant Taxonomy KPIs' denominators (*i.e.* Capex, Opex, turnover) will not be considered material. Furthermore, non-financial undertakings would be allowed not to report on alignment of operational expenditure if the cumulative turnover of their eligible activities do not exceed 25% of total turnover.

Reduced Scope of Reporting for Financial Institutions

For financial institutions, exposure to undertakings other than large undertakings that are required to publish sustainability reports under CSRD (as proposed to be amended by the Omnibus package), would be excluded from the denominator of the applicable KPIs, at least until the Commission has finalized its separate broader review of the Disclosures Delegated Act.

Simplification of Reporting Templates

The proposals would simplify reporting of summary KPIs and "per activity" information. It is anticipated that the proposals would reduce the number of data points reported by 66% for non-financial undertakings and by 89% for credit institutions.

DNSH

The proposals would also amend the Climate and Environmental Delegate Acts in order to address some technical edits to enhance the usability, legal clarity, and consistency of some of the requirements under the "do no significant harm" criteria.

Proposed Changes to CBAM Regime

CBAM entered into force on 17 May 2023 and seeks to address the risk of "carbon leakage" with respect to greenhouse gas (GHG) emissions reductions achieved under the EU Emissions Trading System (ETS), resulting from covered companies either moving their manufacturing operations to jurisdictions outside the scope of the ETS and/or increasing imports from out of scope jurisdictions. CBAM is set to require importers of certain energy-intensive goods and products[12] to pay a tax on imports corresponding to the price of emissions allowances under the ETS.

CBAM is currently in a transitional phase (2023-2025), during which importers of goods in scope of CBAM must monitor and report on embedded GHG emissions, but are not yet subject to a requirement to purchase and surrender CBAM certificates under the "definitive" period which will apply from 1 January 2026.

De Minimis *Threshold*

The most significant proposal in relation to CBAM is the proposal to introduce a more significant *de minimis* exemption (in place of the current €150 value per shipment threshold) with a *de minimis* threshold of 50 metric tons of net mass per importer on a cumulative, annual basis. This exemption would be expected to eliminate CBAM obligations for around 90% of importers (corresponding largely to SMEs and individuals)—though according to the Commission, over 99% of embedded emissions would remain in scope of CBAM. Importers relying on this exemption would be required to identify themselves as "occasional CBAM importers" on customs declarations and ensure that they do not surpass the threshold in any given year.

Other Changes

For importers that remain in scope of the CBAM regime, the Commission proposes to make further changes to facilitate compliance with CBAM obligations. Among others, the Commission proposes to simplify the authorization process for declarants, allow default values to be used in the calculation of embedded emissions, extend annual deadlines to allow additional time for importers to verify emissions and fulfill reporting requirements, permit in-scope importers to maintain an inventory of CBAM certificates equivalent to 50% of emissions at the end of each quarter (down from an 80% requirement), and permit importers to rely on carbon prices paid in third countries (not just the country of origin) to reduce their financial liability under CBAM. The Commission also proposes to strengthen anti-abuse provisions and to develop a joint anti-circumvention strategy together with national authorities. We note the proposed simplification measures precede a scheduled review of CBAM to take place later this year, including to assess expansion to additional sectors.

Procedural Next Steps

The Commission's proposals with respect to CSRD, CSDDD, and CBAM, are subject to review by the European Parliament and Council as part of the ordinary legislative procedure

(level 1 procedure). Upon review, both the Parliament and Council will agree on their respective positions, likely with amendments to the Commission's proposals, following which the three legislative bodies will enter into negotiations (trilogues) to reach a final position.

The "stop the clock" Directive has a specific purpose to delay application of CSRD and CSDDD to buy time for adoption of the more substantive amendments in the substantive Directive. Given this, the Commission has asked for its fast-track adoption and has included in its proposal a transposition deadline of 31 December 2025.

Nonetheless, it is unclear to what extent the Parliament and Council will fast-track the "stop the clock" Directive. It is possible under the ordinary legislative procedure for trilogues and adoption to take at least 18 months. If the "stop the clock" Directive is not transposed in good time (we note a number of EU Member States missed the 6 July 2024 deadline to transpose CSRD into national law), under the current rules, the second wave of companies under CSRD would need to make their first reports available in 2026, in spite of the fact that the Commission is seeking to exempt the significant majority of companies in this second wave from the requirements of CSRD completely.

The proposed Taxonomy Delegated Regulation is open for public consultation until 26 March 2025 and will then be adopted by the Commission. As noted above, the Commission has the ability to adopt these changes directly, albeit subject to the non-objection of the Parliament and the Council.

Immediate Takeaways for Companies

Of all of the proposals set out above, the proposed changes to the scoping and timing under CSRD are likely the most important consideration for the majority of companies. CSDDD is currently further away, and would only apply to the largest companies in scope of CSRD (which are themselves unaffected by the proposed revised scope).

Companies in waves 1, 2, and 3 of CSRD should pay close attention to the unfolding developments surrounding the Omnibus Simplification package, as the outcome could lead to a drastically different compliance burden.

In particular, companies in "Wave 2" should monitor the progress of the "stop the clock" Directive through the EU institutions to determine whether they will be subject to an obligation to publish their first CSRD-compliant sustainability report in 2026 or not. Companies should not assume that even the 'fast track' process will be sufficient to achieve this.

Naturally, companies in Wave 2 should also consider revisiting their current implementation plans for CSRD; however, depending on stakeholder expectations, it may be necessary to complete ongoing double materiality analysis and draft sustainability reports, even if the ultimate end product for such work streams is no longer a CSRD compliant report.

As listed SMEs and SME PIEs are not due to come into scope of CSRD until 2026 (with reporting in 2027), there is less riding on whether the "stop the clock" Directive is passed before the end of 2025. Noting that the Commission is proposing to scope out SMEs from CSRD completely, SMEs may wish to reconsider any ongoing CSRD compliance workstreams. Depending on stakeholder expectations, future voluntary reporting may emerge as a plausible option and the Commission's proposed standards should be kept under review once available.

Finally, while the Commission proposes to increase the net turnover thresholds for non-EU companies to which the third-country CSRD reporting requirements will relate, the Commission has not introduced an employee requirement. This is in line with the scoping provisions for CSDDD. As such, the reduction in scope is arguably less significant as compared to the waves covered EU companies. Non-EU companies that will remain

in scope (via their EU subsidiaries or EU branch) of the third country requirements should continue to assess the requirements, noting that the Non-European Sustainability Reporting Standards (NESRS) proposed recently by EFRAG will likely need to align with any reduction in the volume of information to be reported by EU companies under the ESRS.

Notes

1. As defined in Article 3(4) of the Accounting Directive.

2. As a technical matter, CSDDD explicitly includes part-time employees and temporary workers within the calculation of the employee threshold; whereas, the Commission's CSRD Q&As suggest that in the absence of national rules, only full-time employees would count towards the CSRD threshold. For companies that are close to the 1000 employee threshold, this calculation discrepancy could lead to different outcomes when scoping for CSRD and CSDDD.

3. 'Wave 1' also includes PIEs and issuers that are parent undertakings of a large group which has more than 500 employees on a consolidated basis.

4. The 'stop the clock' Directive does not amend the timing for 'wave 1'; however, 'wave 1' would be deleted if the more substantive Directive is adopted (on the basis that issuers and PIEs must also be large undertakings with more than 1000 employees to be in scope). Nonetheless, it is unlikely that the more substantive Directive will be in force prior to the obligation for 'wave 1' companies to report information for FY 2025 and so all 'wave 1' companies will be required to report again in 2026.

5. The thresholds for a company to be treated as a large undertaking are set out in the first column.

6. As defined in Article 3(2) and (3) of the Accounting Directive.

7. The third country reporting regime introduced by CSRD under Article 40a of the Accounting Directive technically applies to the EU subsidiary or branch, rather than the third country parent undertaking directly.

8. *See* thresholds for large companies applying to "Wave 2."

9. A large EU undertaking would still be required to report under Article 40a in line with the third country reporting standards if its third country parent (or the third country parent's group) met the €450mn net turnover threshold, even if the large EU undertaking does not have 1000 employees and is therefore not subject to sustainability reporting under CSRD itself.

10. For non-EU companies entering into franchising or licensing agreements in the EU, the net turnover and royalty figures must be generated in the EU.

11. The proposed "burden reduction and simplification measures" set out under the Disclosures Delegated Act are separate from the Commission's ongoing review for more substantive changes in the current reporting framework; in particular this review may cover issues related to the calculation of the green asset ratio for banks.

12. Including certain iron and steel goods, aluminum and goods made of aluminum, iron ore and hydrogen, certain fertilizers, electricity and certain mineral products, noting the scope is expected to be expanded in the future (post-transitional phase).

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