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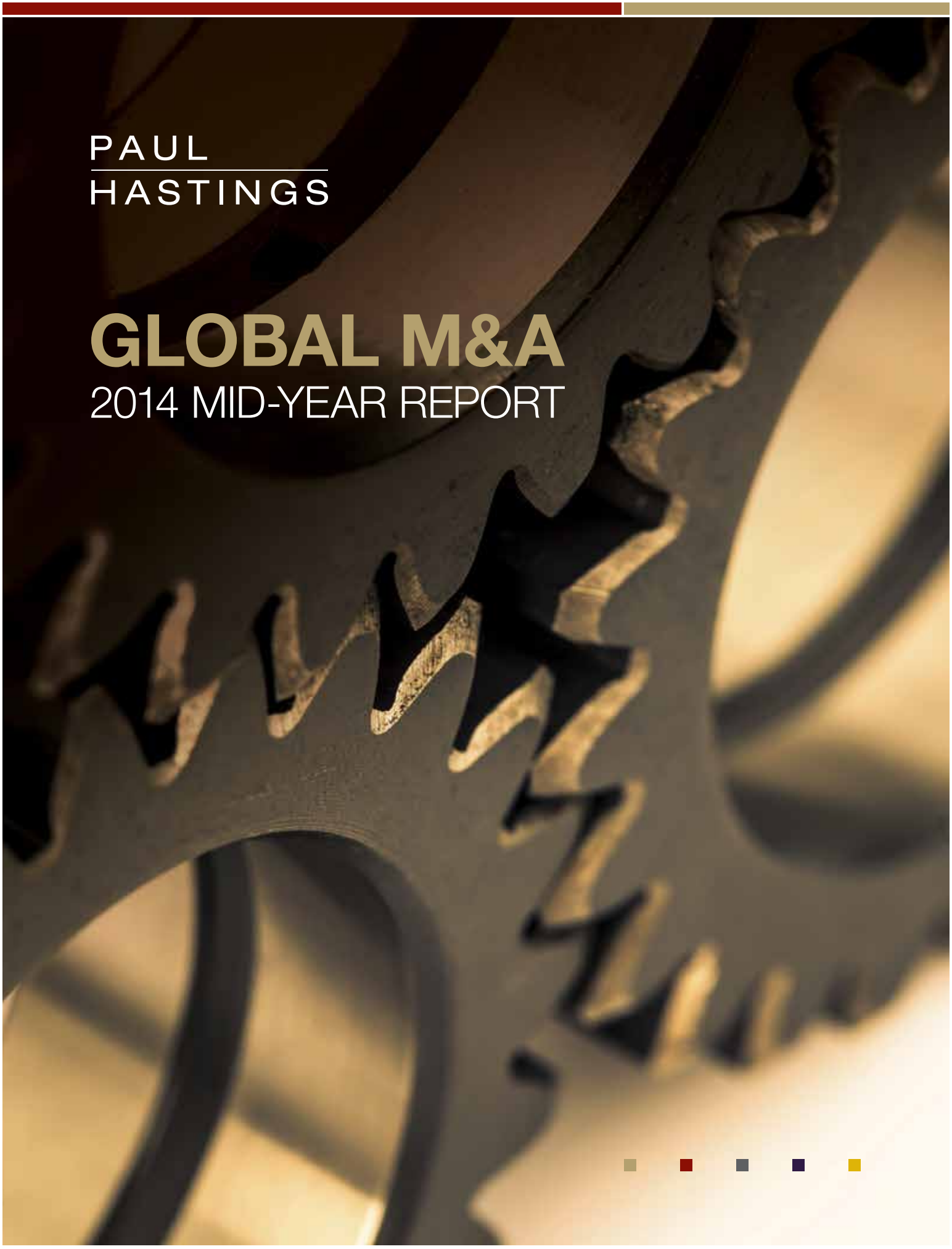
GLOBAL M&A

2014 MID-YEAR REPORT



GLOBAL M&A 2014 MID-YEAR REPORT

CHAIRMAN'S NOTE

We are proud to present the Paul Hastings Global M&A 2014 Mid-Year Report. Our report provides a brief glimpse into some of the issues and topics encountered during the first half of 2014 by our clients and deal teams, as well as a look into how new regulations and case law are changing the landscape of deal making. While a comprehensive review of every issue that has arisen during the first six months of 2014 is beyond the scope of our report, we hope you find the select topics presented within interesting and helpful.

According to Dealogic, total global M&A deal value for the first six months of 2014 was over $1.75 trillion, the highest levels since the financial crisis of 2007, and 44% higher than the same period one year ago. While the total number of deals is down from the same period last year, mega-deals continue to fuel the M&A market. Whether it's Comcast's $45 billion acquisition of Time Warner Cable (telecom), Holcim's $41 billion deal with LaFarge (cement manufacturing) or Medtronic's $42.9 billion acquisition of Covidien (life sciences), the announcement of mega-deals across many sectors seemed almost commonplace in the first half of 2014.

U.S. lawmakers have been busy as well during the first six months of 2014. Whether through new legislation, the issuance of court opinions or heightened scrutiny on cross-border deals, it is clear that U.S. lawmakers are intensifying their review of M&A deal activity, in particular cross-border transactions. In the following pages, we discuss the accelerated pace of China's outbound M&A efforts and the challenges it poses to the Committee on Foreign Investment in the United States (CFIUS) in its review of transactions that raise potential national security issues. As dealmakers, we are cautioned that what we may have historically viewed as an "uninteresting" transaction with respect to national security issues may deserve more careful contingency planning. In addition, we discuss the stepped-up efforts by the United States Department of Justice and the Securities and Exchange Commission in charging individuals and companies doing business with China with violations of the Foreign Corrupt Practices Act and the impact such efforts have had on the deal making process.

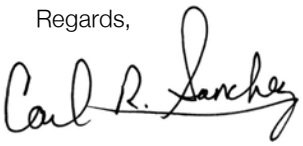
On the European front, dealmakers are facing similar challenges in getting cross-border transactions over the finish line. Whether scuttling deals on a case-by-case basis or adopting far reaching legislation, European politicians have been hard at work to keep up with the siege of foreign investment in high-profile European companies. The negative effects of some of these transactions on European economies, including the local job markets and tax bases, have resulted in public outcry for government intervention.

Viewed through a different lens, you will find that, in some cases, lawmakers and dealmakers are aligned. The passage by the Delaware legislature of new Section 251(h) of the Delaware General Corporation Law in 2013, followed up by clarifying amendments which will take effect later this year, paved the way for dealmakers to adopt a new approach to rapidly complete two-step tender offers. Other changes to the DGCL discussed in this report reflect the state lawmakers' readiness to adopt new legislation to facilitate deal making.

Finally, we have summarized in this report several of the more far-reaching decisions coming out of the Delaware courts in the first half of 2014 and the impact such decisions have on how we, as deal makers and deal lawyers, approach the ever growing complexities of completing deals in a global marketplace.

I want to thank the Paul Hastings partners, associates and counsel for their hard work and contribution to this Global M&A 2014 Mid-Year Report. We hope you find the articles and summaries within helpful as you engage in deal making.

Regards,



Carl R. Sanchez
Partner and Chair, Global M&A Practice Group

REGULATORY OVERSIGHT IN INTERNATIONAL M&A TRANSACTIONS

Accelerating Pace of China Investment Poses Continued Challenges for CFIUS Review

CFIUS' Annual Report, Smithfield Foods, and the Lessons for 2014

Lawyers who work on cross-border M&A transactions involving the acquisition of a U.S. business by a non-U.S. party have learned to accommodate an unpredictable factor in the process of obtaining regulatory clearances for the deal. Working from an office in the Treasury Department, an inter-agency body called the Committee on Foreign Investment in the United States ("CFIUS") oversees an often lengthy and opaque process for reviewing a proposed transaction to determine its impact on U.S. national security. While the process is technically a voluntary one, obtaining pre-closing review and clearance by CFIUS assures that the President will not exercise plenary authority to block or unwind the transaction after the fact.

Most "covered transactions" (*i.e.,* a transaction in which a foreign party acquires control of a U.S. business) pose little or no national security concerns and even if filed will clear CFIUS review without incident or undue delay. However, because of the wary and often tense relationship between the United States and China, acquisition of a U.S. business in a sensitive sector by a Chinese party (and particularly one owned or controlled by the Chinese government) presents particular challenges to the CFIUS process.

2014 is turning out to be a record year for Chinese investment into the United States. The year opened with Lenovo's announcement that it would acquire Motorola Mobility from Google. In immediate succession, Lenovo also announced that it was acquiring a server business from IBM. This followed a 2013 that saw the largest acquisition ever by a Chinese company of a U.S. business: the $7 billion purchase of pork-processor Smithfield Foods by Shuanghui International (now WH Group). As the pace of Chinese investment in the U.S. is accelerating, it is growing more complex and varied, as Chinese consumer companies move to use their financial resources across a global footprint, to secure supply lines and technology advances for rapidly maturing Chinese consumer tastes, and to accelerate access to the U.S. market.

Anticipating how the CFIUS process will accommodate this rise in Chinese transactions is a key challenge for dealmakers and deal lawyers alike. Our firm had the privilege of representing Shuanghui in the Smithfield transaction (including leading the CFIUS review and clearance) and saw up close the competing factors at work in obtaining approval of a high-profile, politically-charged deal.

Two recent reports shed some interesting light on the subject. CFIUS' Annual Report to Congress,[1] issued in the waning days of December 2013, arrived already somewhat stale, as it covers the year *2012.* The second report comes from the respected Rhodium Group, which issued a comprehensive report on Chinese investment in 2013.[2] The Rhodium report provides valuable color in evaluating where the trend lines are pushing the CFIUS process. And it supplies one key data point not yet available from CFIUS: the value of inbound Chinese deals literally *doubled* from 2012 to 2013, largely led by the Shuanghui/Smithfield transaction. It appears that there will be no let up in 2014 as new deals are already in advanced stages of negotiation.

The CFIUS Annual Report

The CFIUS Report, while limited to 2012, contains information that is relevant to current thinking about Chinese investment in the United States.

- ***China had the most deals reviewed of any nation.*** In 2012, for the first time, more investments from China underwent CFIUS review than from any other country. Previously the leader, the U.K. dropped from 26 reviewed deals in 2010 to 17 reviewed deals in 2012. For China, the number of reviews for those years nearly quadrupled, from 6 to 23.

As the number of China deals being reviewed rapidly escalates, so does the experience and sophistication among CFIUS agencies and staff. They know more, they know how to evaluate information better, they understand better what information they can and should seek, and they know better how to counsel the CFIUS applicants who take advantage of the pre-filing consult mechanism in hopes of getting a short – or at least a less difficult – CFIUS review.

- ***Seemingly "innocent" deals can present significant national security issues.*** By far the most prominent deal to be blocked by CFIUS was the Ralls case. This involved the acquisition by a Chinese company of an Oregon wind farm project composed of "sites [that] all are within or in the vicinity of restricted air space at Naval Weapons Systems Training Facility Boardman," which the Navy advertises as its "primary training range on the west coast for conducting low altitude, air combat maneuvers."[3] This case brought to the forefront the importance of "proximity" for even routine deals.

- ***Chinese deals do get rejected.*** The 2012 Report reveals that 22 transactions were withdrawn in 2012, by far the largest figure in recent CFIUS history.[4] Of these, nearly all – 20 – were withdrawn during the second-phase 45-day investigation, signaling that there were problems with the transaction that, at a minimum, could not be resolved before the statutory investigation period expired. Of these, nearly half – 10 of 22 – were not refiled. That suggests those deals failed because the concerns that led to withdrawal could not be resolved, even if additional time was taken to try to address the concerns of the military or intelligence agencies.

The CFIUS Report does not expressly disclose the nationalities of the acquiring parties for those withdrawn reviews. One can safely infer that a large percentage were Chinese: the jump in the number of withdrawn transactions from 2011 to 2012 largely mirrors the jump in the number of Chinese transactions undergoing review.

The Rhodium Report

The Rhodium Group's report on Chinese foreign direct investment (FDI) in 2013 provides more current analysis. It notes that private Chinese firms – companies like Lenovo and Shuanghui – accounted for more than 80% of the transactions,

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1 CFIUS Annual Report to Congress, http://www.treasury.gov/resource-center/international/foreign-investment/Documents/2013%20CFIUS%20Annual%20Report%20PUBLIC.pdf.

2 *Chinese FDI in the US: 2013 Recap and 2014 Outlook,* http://rhg.com/notes/chinese-fdi-in-the-us-2013-recap-and-2014-outlook.

3 *See* http://greenfleet.dodlive.mil/rsc/airspace-compatibility.

4 There was a spike in withdrawn deals in 2008, but 18 of the 23 withdrawals that year occurred during the initial 30-day clock at CFIUS – that is, likely not because approval of deal was in jeopardy, but because of the economic collapse that occurred over the course of 2008.

and more than 70% of the transaction value, in inbound Chinese investment into the U.S. in 2013. Among its key findings:

- The number of Chinese transactions went up in 2013, and the size of the deals grew significantly.
- The sectors most impacted were food, energy, and real estate. Deals in advanced manufacturing were "mostly small and medium in size."
- Chinese acquirers are becoming increasingly visible in local U.S. economies. The number of jobs for Chinese companies in the U.S. grew to more than 70,000, a more than 8-fold increase since 2007.

In 2013 Chinese buyers showed increased comfort and dexterity in dealing with sensitive American properties and issues. In acquiring Smithfield, Shuanghui not only bought several iconic American brands in the pork business; it also acquired a largely unionized workforce, a first for a Chinese acquirer, and it carried out the acquisition with union support. In buying several marquis pieces of New York real estate – the GM Building and Chase Manhattan Plaza – Chinese buyers stepped into a spotlight they had tended to avoid, and one that proved a debacle for Japanese real estate investors 20 years ago.

Rhodium notes one risk to Chinese investment that emerged over 2013: efforts to broaden the "national security" rationale for CFIUS review into a wider "net benefit" test that would call for inclusion of non-security economic consideration in the analysis. One can expect variants of the "food security is national security" argument used in Shuanghui/Smithfield to surface again as transactions closer to mainstream technologies – like Lenovo/Motorola – arise.

But the CFIUS process has shown little inclination to expand into new territory from its already difficult and demanding responsibilities in the zones of military, intelligence, and advanced technology. Its staff faces considerable strain in collecting and synthesizing agency views on the national security issues within the tight timelines specified by the law. Already it seems clear that in a number of cases in which 45-day investigations have been commenced, that result has been driven as much by the difficulty of assembling and evaluating the facts – even when acquiror and acquiree parties come to the transaction with a ready package of data and analysis – as by the need for a deeper second-phase dive into the details.

Looking ahead

The second half of 2014 is likely to bring the hardest challenges yet to the CFIUS process. As the American economy rebounds and the U.S. becomes regarded again as both a safe and an expanding venue for investment, more acquisitions are surely in the works.

Now that Chinese buyers see, from the 2013 examples of Shuanghui/Smithfield and CNOOC/Nexen, that large-scale Chinese acquisitions can succeed – and that the U.S. foreign investment process will be guided in at least some difficult instances by merit, even in the face of political pressure – the data in CFIUS' 2014 report likely will show an even more dramatic expansion of Chinese FDI in U.S. companies. But some of these will be hard cases.

And just as hard cases make for bad law, they make for potentially bad outcomes in the CFIUS process. Those risks are aggravated as the U.S. begins an election cycle leading up to the 2014 Congressional elections, in which a few districts may determine control of both the House and the Senate – and in which a sensitive issue such as a Chinese acquisition of a major employer in one of those districts can reshape the candidates' debate or swing the results. As always, nothing is more important than careful preparation, advance anticipation of problems and issues, full assembly of a public relations and legal team, and dexterous use of the opportunities the CFIUS process presents to prepare the groundwork well before an acquisition is announced.

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Confronting FCPA and Anti-Corruption Risk in China M&A Deals

Fighting corruption around the globe is an increasingly high priority for U.S. enforcement agencies and China lies at the center of that effort. In the last decade, the U.S. Department of Justice ("DOJ") and the U.S. Securities and Exchange Commission ("SEC") have charged more entities and individuals doing business in China with violations of the Foreign Corrupt Practices Act ("FCPA") than any other country except Nigeria.

The increased enforcement focus is a significant challenge to acquirers in China, where government involvement in the economy is pervasive and regulatory barriers are legion. In addition to tax, anti-trust and other regulatory concerns, prudent acquirers must now consider the FCPA's broad application to China-related transactions. Only by taking appropriate pre- and post-closing measures can buyers hope to avoid becoming the focus of a U.S. – or even Chinese – anti-corruption investigation. Fortunately, by (i) conducting rigorous due diligence, (ii) negotiating strong compliance-related contractual provisions and (iii) implementing robust policies and procedures upon closing, acquirers can manage, if not eliminate, the risk of successor liability, financial loss and reputational damage.

The FCPA's Broad Application in China

The FCPA applies to: (i) U.S. issuers (companies listed on a U.S. stock exchange or required to file periodic reports with the SEC); (ii) a citizen, national, or resident of the United States and any business entity organized under the laws of the United States; and (iii) any non-U.S. person or concern that takes an act in furtherance of an improper payment while in the territory of the United States. The FCPA prohibits such entities and individuals from offering, paying or promising to pay money or anything of value directly or indirectly to obtain or retain business, or to gain any other improper advantage from a foreign government official with corrupt intent. The FCPA also requires U.S. issuers to maintain accurate books and records and devise internal accounting controls that accurately reflect transactions for themselves and their consolidated subsidiaries and affiliates.

An analysis of whether a target company falls within the jurisdiction of the FCPA can be straightforward. The target company may employ a U.S. citizen or have a U.S. subsidiary that brings it within the ambit of the FCPA. However, such analysis may be more complicated when trying to determine whether prohibited business activity actually took place "while in the territory of the United States." For example, phone calls to and emails routed through the United States authorizing improper payments, or wire transfers cleared through U.S. banks, may be sufficient to establish a U.S. nexus. Careful analysis of a target's operations, sources of revenue, corporate structure, and management are all required to identify the contours of its FCPA footprint.

The U.S. government has been largely successful in securing judicial recognition of its broad interpretation of the FCPA's application. In a recent decision, the Eleventh Circuit Court generally agreed with the U.S. government's position that an entity is an instrumentality of a foreign government if it is "controlled by the government of a foreign country" and "performs a function the controlling government treats as its own," confirming that the FCPA applies to a wide variety of state-owned entities.[5] In a jurisdiction like China, where state-owned companies employ approximately 70 million people nationwide and even low-level employees of state-owned enterprises may be considered "foreign officials" for the purposes of the FCPA, the potential for anti-corruption violations is considerable.

The FCPA and Successor Liability

Given the FCPA's broad application in China, it is critical that acquirers understand the specific risks they are buying. In the FCPA context, successor liability does not create liability when none existed before. A target company that was not previously subject to the FCPA does not become so retroactively simply because it is acquired by a U.S. entity or issuer. However, the acquirer could still find itself at risk if it fails to identify the target's corrupt business practices

5 *United States v. Esquenazi*, No. 11-15331 (11th Cir. May 16, 2014). *See* Paul Hastings Client Alert, "Appellate Court Clarifies FCPA 'Instrumentality' Definition," available at http://www.paulhastings.com/docs/default-source/PDFs/stay-current-esquenazi-client-alert.pdf.

during the pre-acquisition process and those practices are allowed to continue post-closing. In contrast, if the target is already subject to the FCPA, at the time of closing, an acquirer assumes a host of liabilities, including those arising from the target's preexisting FCPA violations. Those liabilities, however, may be mitigated if the acquirer takes proper remedial measures.

In 2004, RAE Systems Inc. ("RAE"), a California-based manufacturer of chemical and radiation detection equipment, sought to expand in China by acquiring a majority stake in a Chinese joint venture. In the course of due diligence, RAE learned that the joint venture company relied on under-the-table payments to secure deals with government customers. Despite this red flag, RAE failed to implement adequate internal controls in the joint venture to terminate the corrupt practices. Two years later, when RAE formed a second Chinese joint venture, RAE failed to conduct any compliance due diligence. The corrupt practices were allowed to continue and RAE ultimately paid a US$2.9 million fine to settle criminal charges with the DOJ and civil charges with the SEC. While the joint venture companies' pre-acquisition improper payments did not subject RAE to successor liability *per se*, RAE's failure to investigate and remediate its partners' corrupt practices ultimately made RAE the target of U.S. regulators' enforcement actions.

An acquirer may also assume significant liability under Chinese anti-corruption laws when it acquires a Chinese company. While Chinese law does not explicitly address successor liability for anti-corruption violations, the Research Office of the Supreme People's Court has issued guidance stating that, where a company that has engaged in criminal activity merges with another company, the predecessor company and its principals responsible for the wrongdoing may still be prosecuted for violations post-merger.[6] Accordingly, properly assessing and remediating anti-corruption risks can help address anti-corruption liability under both U.S. and Chinese law.

Step 1: Compliance Due Diligence

Given the heightened risk of anti-corruption enforcement, more acquirers are making compliance risk analysis an integral part of their pre-closing due diligence process. Typically, such due diligence involves using written questionnaires to identify (i) former or current government employees of the target company, (ii) state-owned customers or suppliers, (iii) regulatory and licensing requirements, (iv) key government contracts, and (v) third party intermediaries. Understanding how third party intermediaries are used allows the acquirer to assess a target company's exposure to FCPA risks, violations of which often occur through the use of third party intermediaries interacting with government officials. The next level of analysis often includes a review of the target's existing anti-corruption policies and procedures, reputational due diligence regarding directors and officers, and interviews with key managers, customers and suppliers. This legal and reputational due diligence can help determine the necessity of selective transaction testing of the target's books and records in high risk categories such as entertainment, miscellaneous and cash expenditures.

While certain anti-corruption risks can be identified in pre-closing due diligence, others can only be identified post-closing. As the DOJ recognized in FCPA Opinion 08-02 (the so-called "Halliburton Opinion"), in some cases, critical information about the target's anti-corruption risks may be unattainable until the transaction is final. The Halliburton Opinion sets forth a clear (but ambitious) timetable for identifying and addressing such risks post-closing. Accordingly, after the ink dries on the purchase agreement, the acquirer's first action item should be an internal audit of the target's business practices. As an owner, an acquirer will have a different perspective and deeper level of access to books, records, information and employees that could potentially reveal corrupt business practices not identified in pre-closing due diligence.

Any corrupt business practice identified post-closing should be immediately terminated and the acquirer should discuss with legal counsel appropriate remedial measures, including terminating the employees involved, strengthening the company's internal controls, severing problematic business relationships or, in the rare instance, even voluntarily

6 *Response to the Question of How to Hold Criminally Accountable Enterprises with Criminal Acts that have been Merged*, promulgated by the Research Office of the Supreme People's Court on November 18, 1998.

reporting to government regulators. While there is no such thing as a "safe harbor" for pre-acquisition activity under the FCPA, U.S. enforcement agencies place great emphasis on the acquirer's good faith attempts to identify and eradicate corrupt practices in line with their degree of access and control. The best time to go to the U.S. regulators is when problems are identified in a company that has just been acquired.

Step 2: Contractual Protections

Pre-closing due diligence dictates the contractual provisions that an acquirer should seek. These generally include representations, warranties and covenants regarding past and future actions of the target and its directors, officers, employees and agents with respect to compliance with anti-corruption laws. The acquirer should also seek an indemnity to cover any violation that is identified during pre-closing due diligence or that may be uncovered in the future. If a significant compliance issue arises in pre-closing due diligence, a purchase price holdback or indemnity escrow may be used to cover potential liabilities. Ultimately, a purchase price adjustment may be necessary to more accurately reflect the target's value in light of potential compliance risks. In a worst-case scenario, where the parties cannot reach agreement on remedial measures or contractual safeguards, a well-informed acquirer can, and sometimes should, walk away.

Step 3: Policies and Procedures

Concurrently with the post-closing internal audit, an acquirer should also implement a comprehensive compliance program tailored to address both general and specific business risks. An anti-corruption policy that includes a code of conduct, internal reporting and approval procedures, strong financial controls, whistle blowing and monitoring mechanisms and an audit process indicates to the DOJ and the SEC the acquirer's commitment to preventing and eliminating corrupt business practices. Here, implementation is critical. Adopting policies that appear robust on paper but in reality remain untranslated and undistributed can be viewed by the U.S. regulators as worse than having no policy at all. Regular training sessions, rigorous third party due diligence, compliance audits and risk assessments are essential to ensuring that the compliance program is effective.

The FCPA and China's Anti-Corruption Laws

Chinese authorities have begun aggressively enforcing their own domestic anti-bribery laws against both Chinese and non-Chinese entities. Foreign companies operating in China must now confront the additional possibility of becoming the target of a Chinese anti-corruption investigation.

The Chinese government relies on a number of government offices in the enforcement of anti-corruption laws. The Public Security Bureau and the People's Procuratorate are primarily responsible for investigating and prosecuting criminal bribery, while the State Administration for Industry & Commerce ("AIC") enforces commercial anti-bribery laws. Other government agencies enjoy concurrent authority with the AIC over misconduct within the industries that they supervise (i.e., the China Banking Regulatory Commission handles corruption matters related to the banking industry). The Ministry of Commerce also plays a significant role when corruption charges are issued against foreign companies operating in China.

Fortunately for U.S. acquirers, there is broad overlap between the conduct prohibited under U.S. and Chinese anti-corruption laws, with both regimes generally prohibiting the offer of anything of value in order to induce a government representative to confer an improper benefit.[7] However, important differences exist, particularly regarding who is considered a government official. U.S. enforcement authorities take the position that even low-level employees of state-owned enterprises may be considered "foreign officials" under the FCPA. In contrast, only those engaged in "government affairs," i.e., those in positions of management authority, are typically classified as "state functionaries" under Chinese law. Further, companies operating in China must comply not only with laws barring payments to

7 Although the Supreme People's Court and the Supreme People's Procuratorate have held that "property" includes currency, tangible goods and assets that can be denominated in currency, such as housing renovation, membership cards, vouchers, gift cards and payment of travel expenses, it is unclear whether intangible benefits, such as job opportunities, would fall within the scope of this definition.

government officials, but also domestic commercial anti-bribery laws. Accordingly, any anti-corruption policy designed for the Chinese market should specifically address both official and commercial bribery.

Conclusion

In addition to the significant regulatory penalties at stake, ancillary costs such as legal fees associated with internal investigations and defending against shareholder derivative suits can run into the tens of millions of dollars and consume significant management resources. The mere reputational risk of being associated with corrupt activities can jeopardize future business opportunities for any multinational corporation or global investment fund. Accordingly, adopting a thorough due diligence program, comprehensive contractual provisions and robust post-closing policies and procedures are powerful strategies for preserving deal value and avoiding regulatory scrutiny.

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Increased Government Intervention in In-Bound European M&A Deals – A Review of Recent Transactions

European M&A activity has increased over the past years, but it has not been without its difficulties. A string of large cross-border deals has been besieged by regulatory and political interference. The past few years has seen increased scrutiny of cross border M&A deals with shareholders, politicians and other stakeholders expressing more influence on the outcome of deals, which has added a further layer of complexity to planning and successfully executing cross border deals, particularly at the higher end of the market.

France Telecom's plans to sell a majority stake in video-sharing website Dailymotion to Yahoo were derailed by the French government, which opposed one of France's most successful start-ups being purchased by an American suitor. Most recently, General Electric Co.'s proposed €17 billion purchase of Alstrom SA's power business, which would potentially affect issues of national sovereignty, has attracted considerable political controversy in France. The French government initially put a hold on the deal when it was first announced in April and attempted to find a credible European alternative bidder, before then agreeing to take a 20% stake in the target, which will give it the ability to influence the future direction of the company. Although the GE deal now looks set to complete in early 2015, the transaction highlights how government intervention can significantly change both the timing and structure of a deal.

It is not only non-European purchasers that have faced additional scrutiny these past years. In 2011, Italy's Government started talks over the adoption of rules to thwart unwanted foreign takeovers of strategically important sectors in response to a public backlash against French buy-outs of Italian companies. Jeweller Bulgari, energy group Edison and food group Parmalat were all wholly or partially taken over by French companies.

Some European countries have long had a reputation for political influence in relation to the acquisition of companies by foreign investors. However, politicians in countries such as the UK, who historically have long taken a *laissez-faire* approach to such matters, have put such potential deals under far more scrutiny since the global credit crisis.

The takeover of Cadbury by U.S. based Kraft in 2010 prompted a review of the rules governing takeovers in the UK, particularly in relation to information from bidders about their intentions after the purchase, such as in relation to workforce changes. Just one week after publicly promising to keep one of Cadbury's main UK factories open, which was prior to the completion of the takeover, Kraft backtracked and said it would close the plant. Spurred by negative publicity around Kraft's reversal and criticism of the apparent powerlessness of UK regulatory authorities, the review led to stricter Takeover Code rules which were introduced in 2011.

Last month Pfizer, Inc. abandoned its attempt to buy AstraZeneca PLC for nearly £70 billion ending a month-long public fight between two of the world's biggest pharmaceutical companies that sparked political concerns on both sides of the Atlantic over jobs and corporate tax. Pfizer's final decision not to proceed with an offer was published two hours before a 5:00 pm (London time) deadline to make a firm offer or walk away under the UK takeover rules (the so-called "put up or shut up" deadline being an innovation introduced post-Kraft). Pfizer's decision to not proceed with an offer had been widely expected after the board of directors of AstraZeneca refused Pfizer's final offer of £55 pounds a share.

A parliamentary select committee was convened on May 12, 2014 at which the CEO of Pfizer was called to give evidence about his company's intentions in relation to AstraZeneca. At the same hearing, the UK Government's Business Secretary also made clear that the UK Government would consider intervention if necessary. However, given that anti-trust matters would be handled at the European level, there would have been no legal basis for such intervention without new legislation.

In order to mitigate such pressure, Pfizer assured the UK Government that under its plans, the new merged company would (i) complete investment in a new facility within the UK, (ii) retain a fifth of its global R&D spending in the UK, (iii) base its scientific leadership in the UK, (iv) locate its global headquarters in the UK, and (v) retain a "substantial" manufacturing presence within the UK. However, pursuant to the UK takeover rules, these promises only last for five years and are explicitly subject to any significant change in the commercial environment. The binding effect of such promises has never been tested to date.

Despite all of this political pressure, in the end, what was most likely to have prevented the offer from proceeding was the view of long term institutional investors, who had signaled to AstraZeneca and the market that an offer less than £58 per share would not be acceptable to them. The increased protectionism and political scrutiny means acquisitive corporations need to undertake more pre-acquisition planning to anticipate all possible issues from multiple constituencies and should consider their publicity strategy carefully, given the potential fall-out if bidders are seen to renege on pre-acquisition promises. Clearly, there are a number of reasons why high value, complex cross-border mergers fail, and political considerations are only a single piece of the puzzle, but the additional scrutiny is an unwelcome drag on the rebound of European M&A.

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The German Foreign Trade Law and Its Effects on International M&A Transactions

The German government recently passed new versions of the German Federal Act on Foreign Trade (*Außenwirtschaftsgesetz*) and the German Foreign Trade Ordinance that became effective on September 1, 2013 (the "German Foreign Trade Law").

Under the German Foreign Trade Law, the German Federal Ministry of Economics and Technology (the "Ministry") has the ability to review and prohibit an M&A transaction if a person or entity not located in the European Union[8] ("Foreign Buyer") directly or indirectly acquires a company located in Germany and certain criteria are met.

If the Ministry prohibits the transaction, the parties must reverse such transaction. In order to enforce a prohibition, the Ministry is entitled to prohibit the exercise of voting rights or to appoint a trustee who has the power to reverse the transaction.

Requirements for Potential Prohibition

The review process becomes relevant if the following requirements are met:

A Foreign Buyer acquires a company or at least 25% of the voting rights in a company domiciled in Germany. If certain preconditions are met, an indirect acquisition will also be subject to the new legislation, for example, where

- the acquired company has a (direct or indirect) subsidiary in Germany,
- a Foreign Buyer acquires 25% of a third party that has voting rights in a company in Germany, or
- a Foreign Buyer holding a direct or indirect participation of at least 25% in a company located in Germany acquires, directly or indirectly, an additional participation in such company.

In order for the Ministry to prohibit a transaction, the transaction must endanger the public order or security of the Federal Republic of Germany. This means that the transaction must either affect material legal interests such as the existence, function and supply of the German population or substantive issues regarding national and international security, in particular the operation of the German economy, German institutions, important public services and the survival of the German population.

Telecommunication, electricity, energy and water supply are considered to be important sectors.

Review Process

There is no obligation of the parties to notify the Ministry. However, if the Ministry obtains information about the transaction (e.g., through publications from the cartel authorities or public media), the Ministry is entitled to initiate a review of the transaction within three months after signing of the transaction documents. The Ministry must then inform the buyer of its decision and the buyer must provide the Ministry with the transaction documents.

If the Ministry is of the opinion that the transaction endangers public order or security of the Federal Republic of Germany, it is entitled within a two-month period to prohibit the transaction or to give orders in connection with the transaction. This two-month period begins once the Ministry has received all information necessary for its decision.

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8 Exceptionally, buyers located in the member states of the European Free Trade Association (EFTA) and buyers located in Iceland, Liechtenstein, Norway or Switzerland shall not be considered as Foreign Buyers pursuant to the Foreign Trade Legislation.

Obtaining Legal Certainty via a Foreign Investment Clearance Certificate

If the parties would like to obtain sufficient assurance as to whether the transaction presents a threat to public order or security in order to avoid a prohibition or reversal after a transaction has been consummated, the purchaser may submit a request for a clearance certificate ("Foreign Investment Clearance Certificate"). If the Ministry issues such certificate or does not initiate a review process within one month after receipt of the written application for a Foreign Investment Clearance Certificate, it is not entitled to review the transaction again with respect to a potential conflict with the regulations of the German Foreign Trade Law.

Recommendation

The parties to a transaction with a likelihood of review may not want to risk the Ministry prohibiting the transaction once the transaction has been completed.

In order to avoid such risk, the parties to a transaction should include a closing condition in the purchase agreement requiring the receipt of a Foreign Investment Clearance Certificate or the passing of one month after the Ministry's receipt of the written application for a Foreign Investment Clearance Certificate in order to ensure that the transaction will not be prohibited or reversed following signing or completion.

Over the last few months, it appears that the Ministry has been notified of most transactions involving Foreign Buyers of a significantly large volume. So far, no negative outcomes in the process have been observed. However, we recommend to further monitor the development and to take the German Foreign Trade Law requirements into account when planning an international M&A transaction involving companies in Germany.

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AMENDMENTS TO THE DELAWARE GENERAL CORPORATION LAW

Tender Offers: Past, Present and Future—the Evolution of Section 251(h)

The deal community has warmly embraced the enactment of Section 251(h) of the Delaware General Corporation Law ("DGCL") since it became effective on August 1, 2013. As of June 30, 2014, 35 of the 38 third party tender offer deals executed since the implementation of Section 251(h) have opted to take advantage of the statute, which was intended to bridge the gap that existed between the majority vote requirement of a long-form merger under Section 251(c) and the 90% threshold of a two-step tender offer and short-form merger under Section 253. The key feature of Section 251(h) is that it lowers the ownership threshold at which a buyer can effect a second-step merger without a vote of the target's stockholders. Specifically, Section 251(h) allows a buyer who, following consummation of a tender offer, owns a sufficient percentage of the shares (usually a simple majority) of its publicly held target as would be necessary to approve the merger agreement under Delaware law and the target's certificate of incorporation to effect a second-step merger without a vote of the target's stockholders.

However, some practical questions have arisen regarding its implementation and Delaware lawmakers again responded to the concerns of practitioners with amendments to Section 251(h) that will answer those questions and improve the statute's overall utility. The amendments which were signed into law by the Delaware Governor on July 15, 2014 and which will take effect on August 1, 2014, among other things, (i) clarify ownership and timing requirements, (ii) provide flexibility between the use of Section 251(h), Section 253 of the DGCL or a long-form merger, and (iii) eliminate the restriction against the use of Section 251(h) by an "interested stockholder."

Prior to the Enactment of Section 251(h)

Prior to the enactment of Section 251(h), buyers who wanted to avoid the expense and delay of a stockholder vote to approve a merger had the option to pursue a two-step transaction with a tender offer followed by a statutorily permitted short-form (or second-step) merger without a vote of the target stockholders; however, this option was only available to buyers who could obtain the statutorily required minimum of 90% of the target's shares in the front-end tender offer. If necessary, buyers could close the front-end tender offer and use subsequent offering periods to achieve the 90% threshold requirement. In addition, buyers typically negotiated for a "top-up" option that enabled them to buy the shares needed to reach the 90% threshold directly from the target company, but this ace in the hole could only be played if the target had enough authorized and unissued shares to get the buyer to 90%. Buyers who were ultimately unable to achieve the 90% threshold necessary to bypass the stockholder vote and effect a short-form merger found themselves in the very position they were trying to avoid: filing a proxy statement and waiting for a vote of the target's stockholders to approve the transaction, despite the fact that they had obtained greater than a majority of the target's shares in the tender offer.

Lingering Questions

Timing: Consummation and Ownership—When May a Buyer Proceed under Section 251(h)?

The goal of parties to a tender offer is typically to close the second-step merger immediately following the closing of the first-step tender offer, often within minutes or hours. However, Section 251(h), while requiring that the tender offer be "consummated" before the buyer can proceed with the second-step merger, does not expressly state when consummation of the tender offer has been deemed to occur such that a buyer can proceed with the second-step merger. The meaning of "consummation" is significant, as it marks the specific point in time at which a buyer must own the requisite number of shares to qualify for Section 251(h), which dictates how quickly a buyer can close the second-step merger.

Another issue with the completion of a two-step transaction under Section 251(h) arises with respect to the buyer's "ownership" of target shares following consummation of the first-step tender offer. In order for a buyer to effect a second-step merger without a vote of the target's stockholders, Section 251(h) requires that following the consummation of the tender offer, the buyer "owns" at least such percentage of the stock of the target that, absent Section 251(h), would be required to adopt the merger agreement under the DGCL and the target's certificate of incorporation (i.e., usually, a majority of the outstanding shares, which is consistent with the voting requirement of Section 251(c) of the DGCL). Similar to the "consummation" requirement, Section 251(h) is silent as to what shares are included in the calculation of ownership and whether such calculation should be on a fully-diluted basis or basic shares outstanding basis.

Fear of Commitment: Opting In While Maintaining an Out

Parties who want to take advantage of Section 251(h) must specifically "opt in" via a statement in the merger agreement that "expressly provides that such merger shall be governed by" Section 251(h), and the merger agreement must provide that the merger will be effected as soon as practicable following consummation of the tender offer.

Interested Stockholders Not Welcome

Unlike a traditional tender offer with a second-step short-form merger under Section 253 of the DGCL, Section 251(h) is not available for transactions involving a buyer that is an "interested stockholder" (as defined in Section 203 of the DGCL), regardless of whether the target has opted out of Section 203 or an exemption to Section 203 would otherwise apply. This limitation has been perceived as prohibiting a buyer in an arms-length transaction from entering into tender and support agreements with target stockholders who collectively own 15% or more of the target's voting stock, which leaves buyers faced with a choice between the efficiency and cost-effectiveness of Section 251(h) and the security of locking up greater than 15% of the target shares. At least some commentary has suggested that because Section 251(h) represents such a significant change in the transactional landscape, lawmakers wanted to restrict its applicability, at least initially, to deals where conflicts were less likely to exist.

The Future: Responding to Questions and Refining Section 251(h)

With less than a year of Section 251(h) experience in their rearview mirror, Delaware lawmakers have already taken steps to address the questions referenced above with recent amendments to Section 251(h) that will take effect for merger agreements executed starting on or after August 1, 2014. The amendments, among other things, (i) define "consummation" and clarify the ambiguity surrounding "ownership" requirements, (ii) provide flexibility between the use of Section 251(h), Section 253 of the DGCL or a long-form merger, and (iii) eliminate the restriction against the use of Section 251(h) by an "interested stockholder."

Timing: Consummation Defined and Ownership Clarified

As discussed earlier, the term "consummation" (and correlative terms) was not originally defined under Section 251(h), which had led to uncertainty as to when a buyer may proceed with effecting a second-step merger under Section 251(h). Reflective of the statute's purpose—to enable parties to expeditiously effect a second-step merger upon receipt of the requisite level of tenders—the recently adopted amendments define "consummation" as the irrevocable

"acceptance for purchase" of the shares tendered, thus eliminating any uncertainty as to when the buyer may proceed with effecting the second-step merger, assuming buyer meets the requisite ownership threshold.

In addition, the amendments also clarify when a buyer is deemed to "own" target shares (and which shares are counted) for purposes of allowing the buyer to proceed with the second-step merger. The amendments provide that following the consummation of the offer, the stock irrevocably accepted for purchase and received by the depository prior to the expiration of such offer, plus the stock otherwise owned by the buyer equals at least such percentage of stock of the target that, absent Section 251(h), would be required to adopt the merger agreement under the DGCL and the target's certificate of incorporation. The term "received" is defined as the "physical receipt of a stock certificate in the case of certificated shares and transfer into the depository's account, or an agent's message being received by the depository, in the case of uncertificated shares." Notably, the amendment makes clear that shares delivered via a notice of guaranteed delivery would not be deemed "owned" by the buyer for purposes of Section 251(h). In addition, because satisfaction of the ownership requirement is determined immediately following consummation of the tender offer and only those shares received by the depository plus those shares otherwise owned by the buyer are counted for purposes of determining whether a buyer can proceed with a second-step merger under Section 251(h), the need for basing ownership calculations on a fully diluted share count should be unnecessary.

No Commitment Necessary: Maintaining a Backup Plan

The amendments also make it clear that the parties may draft the merger agreement to either permit or require the merger to be governed by Section 251(h), whereas the statute as originally drafted could be interpreted as obligating the parties to enter into a merger agreement that requires Section 251(h) treatment. A merger agreement that "expressly (i) permits or requires such merger to be effected under" Section 251(h) may take advantage of the statute's benefits, but a merger agreement drafted to permit rather than require the use of Section 251(h) also allows the parties to retain the option to pursue the merger under a different method (e.g., a long-form merger) if they become unwilling or unable to proceed under Section 251(h). However, because the parties in this scenario may turn to a traditional tender offer structure or long-form merger, many of the provisions that could otherwise be trimmed out of a merger agreement in the Section 251(h) context will have to be retained, thus removing some of the simplicity offered by the statute. Regardless of whether the merger agreement merely permits or actually requires the use of Section 251(h), the revised statute continues to require that "such merger shall be effected as soon as practicable following consummation of the offer … if such merger is effected under" Section 251(h).

Interested Stockholders: The Ban is Lifted

Perhaps the most significant change in the amendments is the elimination of the restriction against the use of Section 251(h) by an "interested stockholder." This change will alleviate a buyer's fear that entering into arrangements with target stockholders could cause the buyer to become an "interested stockholder" and render the deal ineligible for Section 251(h). As a result, the market will likely experience a resurgence in the use of tender and support agreements between buyers and key target stockholders, which buyers were otherwise abandoning in favor of Section 251(h) treatment. In addition, this change will likely expand the use of the tender offer structure in "going private" transactions.

Additional Amendments

Additional revisions contained in the amendments are aimed at the more administrative aspects of structuring the tender offer. The amendment clarifies that the buyer's tender offer for "any and all of the outstanding stock" of the constituent corporation may exclude those shares owned by "(i) such constituent corporation; (ii) the corporation making such offer; (iii) any person that owns, directly or indirectly, all of the outstanding stock of the corporation making such offer; or (iv) any direct or indirect wholly-owned subsidiary of any of the foregoing." The revised statute's explicit reference to the exclusion of these shares more accurately reflects the mechanics already being employed by tender offer parties. In further clarifying which target shares are the subject of the statute, the amendments provide that the shares that are "the subject of and not irrevocably accepted for purchase or exchange in the tender offer" must receive the same consideration in the second-step merger as those tendered into the offer. The foregoing two changes, taken together, reinforce the ability of the parties to essentially ignore shares associated with the constituent corporations for purposes of the tender offer and provide for the cancelation of those shares in the second-step merger.

Conclusion

It remains to be seen whether the recently adopted amendments will answer all of the questions raised by the implementation of Section 251(h) or if further refining will be necessary. What is clear is that Delaware lawmakers continue to be responsive to the concerns of practitioners and are determined to craft an effective statute. The market stands ready to take advantage of all the benefits Section 251(h) has to offer.

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2014 Amendments to the Delaware General Corporation Law – Procedural Simplifications

In addition to the recently approved amendments to Section 251(h) of the Delaware General Corporation Law ("DGCL") that clarify ambiguities raised by implementation of Section 251(h) which eliminated the need for a stockholder vote on back-end mergers in two-step tender offers, House Bill #329 approved additional changes to the DGCL that will impact Delaware corporations beginning on August 1, 2014 (the "2014 DGCL Amendments").

Section 141(f) and 228(c) Amendments – Springing Director and Stockholder Consents

In response to *AGR Halifax Fund, Inc. v. Fiscina,* where the Delaware Court of Chancery ("Court") raised issue with the effectiveness and validity of written consents executed by individuals who had not yet become directors at the time of execution, the 2014 DGCL Amendments modify Section 141(f) to allow for such springing consents. Although the consents at issue in *AGR* were to be held in escrow and delivered after the future directors were appointed to the board, the Court found that individuals who were not yet directors could not execute consents prior to the time of appointment as a director. The changes to Section 141(f) of the DGCL will provide flexibility to practitioners and individuals selected to become directors of a corporation, and specifically in the context of merger transactions where a target board is replaced upon effectiveness of the merger and written consents of the new board members are often requested and collected prior to the consummation of the transaction. As amended, Section 141(f) will allow for springing director consents so long as: (1) instructions are provided to an agent or otherwise to hold such consent in escrow until a future effective time (which may be conditioned upon the occurrence of an event); (2) the individual actually becomes a director on or before the time of effectiveness; (3) the consent is not revoked prior to its effectiveness; and (4) the escrow period is no longer than 60 days from the date of escrow. If such conditions are satisfied, the written consent shall be deemed to have been given at the effective time.

The 2014 DGCL Amendments also include similar changes to Section 228(c) of the DGCL, which governs the requirements for written consents of stockholders. Although the requirements for springing stockholder consents are substantively similar to those governing written director consents, the amendments to Section 228(c) specify that the effective time of the written consent of a stockholder shall serve as the date of signature (while contrastingly, the changes to Section 141(f) provide specifically that the written director consent shall "be deemed to have been given" at the effective time).

Section 242 – Stockholder Votes on Certificates of Amendment

The amendments to Section 242 of the DGCL eliminate the requirement of a stockholder vote in order to amend a certificate of incorporation to (a) change the company's name, (b) delete provisions naming the incorporator(s), initial board of directors and/or original subscribers of shares, or (c) to delete provisions contained in any amendment to the certificate of incorporation that were necessary to change, exchange, reclassify, subdivide, combine or cancel stock after such change, exchange, reclassification, subdivision, combination or cancellation has become effective, unless otherwise expressly required by the certificate of incorporation.

Furthermore, the amendments eliminate the requirement set forth in Section 242 that the notice of a stockholders meeting to vote on an amendment to the certificate of incorporation contain a copy of the amendment itself or a brief summary thereof, but only when notice constitutes a notice of internet availability of proxy materials for Securities Exchange Act of 1934 purposes.

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RECENT DELAWARE JUDICIAL DECISIONS IMPACTING M&A

Sotheby's Poison Pill Usage Upheld by Delaware Court of Chancery — *Third Point LLC v. Ruprecht*

In *Third Point LLC v. Ruprecht*, the Delaware Court of Chancery (the "Court") held that the Board of Directors of Sotheby's had not breached their fiduciary duties by adopting and refusing to waive the application of a two-tiered stockholder rights plan (also known colloquially as a "poison pill") during a preliminary injunction hearing in an attempt to enjoin Sotheby's from holding its annual meeting. Third Point LLC ("Third Point"), Sotheby's largest stockholder at the time the suit was brought, claimed that the Sotheby's Board of Directors had violated their fiduciary duties by adopting the rights plan and refusing to provide a waiver to Third Point, in an attempt to obtain an unfair advantage in an upcoming proxy contest.

Utilizing the standard two-prong *Unocal*[9] test, the Court held that plaintiff Third Point failed to persuade the Court that there was a reasonable probability of success on the merits of their claim. The Court identified that the concept of negative control—essentially, a controlling influence without paying a premium to stockholders—by a stockholder without an express veto right or 20% control could reasonably be seen as a threat to corporate policy, and thus justified defensive action by the Board, including the adoption of a rights plan.

This poison pill adopted by Sotheby's contained several notable provisions: a two-tiered triggering mechanism, a one-year term and a qualifying offer exception. Under the two-tiered structure, "passive investors" could acquire up to a 20% ownership interest in the Company, while an "activist stockholder" could only acquire up to 10% before triggering the poison plan. Additionally, under the qualifying offer exception, the poison pill would not be triggered as the result of "an 'any-and-all' share offer for the Company that cashes out all Sotheby's stockholders and gives them at least 100 days to consider the offer." Finally, the poison pill would expire after a one year term unless approved by a shareholder vote. However, there were no restrictions that would prevent the Sotheby's Board from approving a new plan after the one year term expired.

The Court determined that the rights plan would have to be assessed under the standard set forth in *Unocal*, which has long been considered the seminal case for determining the validity of a contested rights plan. In order for a poison pill to be valid under the *Unocal* analysis, the poison pill must (i) be reasonable, which is "satisfied by a demonstration

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9 *See Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 949 (Del. 1985).

that the board had reasonable grounds for believing that a danger to corporate policy and effectiveness existed," and (ii) satisfy a proportionality test by a demonstration that the board of directors' defensive response was appropriate in relation to the proposed threat.

With respect to the adoption of the poison pill, the Court focused on the concept of "creeping control." When the Company's Board initially adopted the poison pill, the three activist hedge funds spearheaded by Third Point were actively buying large portions of Company stock, with the openly stated goal of replacing management and forcing a short slate of directors onto the Board. In consultation with their legal and financial advisors, the Board was informed that activist funds will commonly attempt to buy large allotments of stock in an effort to exert control without paying any sort of premium to shareholders. This type of "de-facto" control, coupled with the track record of these three particular activist funds attempting to exert control over their investments, strengthened the Company's claims that the activities of Third Point and its allied funds could exert creeping control over the Company, and the Court found such control poses an objectively reasonable threat to the Company.

Further, the Court found that the main purpose behind the Sotheby's Board adopting the poison pill was not to undermine a stockholder vote in a coming proxy contest. The Company's Board was primarily independent from management, and the Court felt that the Board's actions were not meant solely to frustrate a stockholder challenge and preserve its members' incumbency. In fact, the Court found that the Company's Board had a shorter average term for its members than many other S&P 500 companies. The Court went on to find that the proxy contest was "eminently winnable by either side" and did not contain coercive features that would unduly comprise such a contest.

Conclusion

The Third Point lawsuit is the first to challenge a two-tier ownership structure included in a poison pill. Despite Third Point's arguments that such a structure unfairly gave an advantage to incumbent management in a potential proxy contest and "open[s] the door to future efforts to squash outspoken stockholders," the Court confirmed that under Delaware law, there is no regulation which prevents a company's board from taking defensive measures to influence a potential stockholder vote, provided that the actions taken by the board are proportionate to the recognized threat, and do not compromise the effectiveness of the stockholders' voting power.

It appears that with this decision the Court is prepared to allow for the use of a two-tier poison pill, provided that the circumstances surrounding its adoption are appropriate, and satisfy the long-held *Unocal* standard. This provides for discrete takeaways to boards considering utilizing a similar tactic in protecting corporate interests:

Board Actions Should Be Clear and Concise

A key component of the Court's support of Sotheby's was the clear, careful consideration that the Board used in analyzing and responding to the threat posed by the activist stockholders. It is imperative that a board of directors clearly discusses the specific threat, as well as their planned actions in response to the threat. These discussions will serve as the basis for supporting a company's defensive actions, and should be clearly memorialized in the company's minute books (and not entered into the minutes in anticipation of litigation, which the Court has been very strict with in recent decisions). By continuing to adhere to a formal, recorded meeting structure, there will be a proper record for a company whose defensive measures come into question.

Defensive Measures and Poison Pills Can be Instituted for Future Threats

The Court was willing to accept the threat posed by a coalition of activist hedge funds long-term shareholder value as sufficient justification to defend Sotheby's use of the two-tiered poison pill. Similarly, institutional investors who act in an "aggressive" manner, or attempt to join into a "wolf pack" to exert control over a target company provide sufficient justification for a board to consider such a targeted poison pill. Provided that the company be able to adequately identify (and document such identification) a threat to long-term shareholder value, it should be able to utilize a more custom-tailored poison pill to continue to preserve the company's value and practices.

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Delaware Supreme Court Holds that a Fee-Shifting Bylaw is Not Invalid Per Se — *ATP Tour, Inc. v. Deutscher Tennis Bund*

On May 8, 2014, in *ATP Tour, Inc. v. Deutscher Tennis Bund*, the Delaware Supreme Court, sitting en banc of Chancery (the "Court"), opined on four narrow questions of law, holding that "fee-shifting provisions in a non-stock corporation's bylaws can be valid and enforceable under Delaware law."

The questions of law arose out of a dispute between ATP Tour, Inc. ("ATP"), a Delaware membership corporation that operates a global men's tennis tour, and three entities that own and operate tennis tournaments associated with the tour (the "Federations"). When the Federations joined ATP in the early 1990s, each "agreed to be bound by ATP's Bylaws, as amended from time to time." In 2006, the ATP board unilaterally amended the bylaws of the corporation to include a provision that shifted attorneys' fees and costs to unsuccessful plaintiffs in disputes between ATP and its members. In 2007, the ATP board voted to change the tour schedule and format, part of which downgraded and moved to a different time of year the portion of the tour operated by the Federations. The Federations opposed these changes, and the resulting lawsuit alleged federal antitrust claims and Delaware fiduciary duty claims.

Legality and Enforceability of a Fee-Shifting Bylaw Enacted After a Member Joins a Corporation

The Federations did not prevail on any claim. ATP's attempt to recover its legal fees using the bylaw amendment gave rise to the four questions of law at issue in the *ATP Tour* decision, all of which related to the legality and enforceability of a fee-shifting bylaw enacted after a member joined a corporation:

(1) May the Board of a Delaware non-stock corporation adopt a bylaw that requires a member to pay all litigation costs in the event that the member sues the corporation and "does not obtain a judgment on the merits that substantially achieves . . . the full remedy sought"?

(2) May such a bylaw be enforced against a member that obtains no relief at all on its claims against the corporation, even if the bylaw might be unenforceable where the member obtains only partial relief?

(3) Is such a bylaw rendered unenforceable if the Board subjectively intended the bylaw to deter legal challenges by members to other potential corporate action then under consideration?

(4) Is such a bylaw enforceable against a member if it was adopted after the member had joined the corporation, but where the member had agreed to be bound by the corporation's rules "that may be adopted and/or amended from time to time"?

The Court found that, "to be facially valid, a bylaw must be authorized by the Delaware General Corporation Law ("DGCL"), consistent with the corporation's certificate of incorporation, and its enactment must not be otherwise prohibited." Because neither the DGCL nor any other Delaware statute "forbids the enactment of fee-shifting bylaws," they are facially valid. In addition, the Court held that the intent to deter litigation would not necessarily render bylaws unenforceable in equity. Finally, a bylaw amendment enacted by the Board of Directors is enforceable against members who join the corporation before its enactment, provided that the directors are authorized to amend the bylaws in the corporation's certificate of incorporation. However, the Court did not (and could not) reach a factual determination of whether ATP's specific fee-shifting bylaw was enforceable or whether it had been adopted for an improper or proper purpose.

Legislative Impact

In response to the *ATP Tour* decision, the Delaware State Bar Association proposed a bill that would limit the decision to non-stock corporations, thereby keeping the ruling from becoming applicable to the vast majority of for-profit

corporations domiciled in Delaware. The U.S. Chamber of Commerce's Institute for Legal Reform opposed the State Bar's bill on the grounds that it was designed to protect frivolous lawsuits that benefitted the plaintiffs' trial bar. As a result of the debate over the proper use of fee-shifting bylaws, the legislature has tabled the proposed bill until at least January 2015 and asked the corporate section of the Delaware State Bar Association to "continue examination" of fee shifting. Therefore, the applicability of the *ATP Tour* decision to stock corporations will remain uncertain for the foreseeable future.

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Business Judgment Standard of Review Applicable in Certain Controlling Stockholder Buyouts — *Kahn v. M&F Worldwide Corp.*

On March 14, 2014, the Delaware Supreme Court held in *Kahn v. M&F Worldwide Corp.* that the business judgment standard of review applies to a controlling stockholder buyout in a going private transaction if, from the beginning, the transaction is conditioned on "both the approval of an independent, adequately-empowered Special Committee that fulfills its duty of care; and the uncoerced, informed vote of a majority of the minority stockholders."[10]

Case Background

In 2011, MacAndrews & Forbes Holdings, Inc. ("MacAndrews & Forbes"), a 43% stockholder in M&F Worldwide Corp. ("MFW"), submitted a proposal to the board of directors of MFW to acquire the remaining common stock of MFW for $24 per share. The proposal was contingent upon the approval of both a special committee of independent directors of MFW and a majority of the stockholders not affiliated with M&F.

The independent MFW directors formed a special committee to evaluate the proposal. Among other things, the committee was empowered to investigate the proposal, hire its own advisors, negotiate with MacAndrews & Forbes, report its recommendations to the board, including whether the proposal was fair and in the best interests of MFW's stockholders not affiliated with MacAndrews & Forbes, and determine whether or not to pursue the proposal. Based on its mandate, the committee hired its own independent legal and financial advisors, reviewed various valuations of the company and considered whether alternative transactions would yield a higher price for minority stockholders. (Despite the fact that MacAndrews & Forbes indicated in their proposal that they would not be willing to sell their stock to a third party, the alternatives the committee considered included asset divestitures as well as a potential sale to another buyer.) The committee submitted a counterproposal to MacAndrews & Forbes for $30 per share, and MacAndrews & Forbes agreed to a price of $25 per share, which the committee recommended to the board. The transaction was submitted to the non-affiliated stockholders for approval, with a description of the negotiation process, and 65.4% of MFW's non-affiliated stockholders approved the proposal.

Certain non-affiliated stockholders filed suit, initially seeking to enjoin the transaction and later, after withdrawing their request for an injunction, seeking post-closing relief against M&F and its directors for breach of fiduciary duty. The Court of Chancery granted summary judgment in favor of the defendants, holding that the business judgment standard of review applied to the matter, and the Delaware Supreme Court affirmed.

Practical Implications

Delaware courts have long applied business judgment review to arms'-length transactions with a non-interested third party if the transaction was approved by the company's stockholders and a disinterested board. Under business judgment review, the plaintiff must show that no rational person could have believed that the transaction was favorable to the stockholders. In contrast, prior to the *MFW* decision, Delaware courts had applied the "entire fairness" standard of review to going private transactions with controlling stockholders. Under the entire fairness standard, at the outset the burden is on the defendant(s) to show that the transaction was entirely fair to the minority (or non-affiliated) stockholders, but Delaware courts shift the burden of proof to the plaintiff, requiring the plaintiff to show that the transaction was not entirely fair to the minority stockholders, if the defendant(s) can show that the transaction was either approved by an independent special committee or by a majority of the minority stockholders. In *MFW*, the court addressed for the first time the standard of review that applies if both of those criteria are met.

As a result of *MFW*, if a going private transaction meets the relevant criteria (as discussed below), instead of showing that the transaction was not entirely fair to the minority stockholders, the plaintiff faces the more difficult task of showing that no rational person could have believed that the transaction was favorable to the minority stockholders.

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10 *Kahn v. M&F Worldwide Corp.*, Case No. 334, 2013 (Del. 2014), op. at 15.

This higher standard makes it more likely that companies will be able to secure a dismissal or summary judgment in their favor.

The *MFW* decision provides a roadmap for buyers and companies seeking to ensure that the business judgment review standard applies to their transaction. The court discussed six criteria that must be met to apply the business judgment standard of review: "(i) the [controlling stockholder] conditions the procession of the transaction on approval of both a Special Committee and a majority of minority stockholders; (ii) the Special Committee is independent; (iii) the Special Committee is empowered to freely select its own advisors and to say no definitively; (iv) the Special Committee meets its duty of care in negotiating a fair price; (v) the vote of the minority is informed; and (vi) there is no coercion of the minority."[11]

Following are some practical suggestions for parties considering a going private transaction with the controlling stockholder of a Delaware company, to make it more likely that business judgment review will apply to any subsequent litigation challenging the transaction:

- Make sure the proposal is conditioned at the outset on the approval of both an independent special committee and a majority of non-affiliated stockholders. (The Delaware Chancery Court has found that a subsequent decision to submit the transaction to a vote of the minority stockholders will not satisfy the *MFW* criteria.[12])

- Make sure the conditions of the proposal and the authority of the committee are clearly documented in the proposal and in the resolutions establishing the special committee. Among other things, the resolutions should provide that the committee has the authority to negotiate with the buyer, to select its own advisors and to say no to the transaction.

- Carefully consider and develop a record of special committee independence. Look for any economic, social, family or other ties between committee members and the buyer that could be viewed as material, and if needed consult the developed body of Delaware case law on independence.

- Develop a record demonstrating that the committee has diligently carried out its mandate by, for example, holding regular meetings, consulting with independent financial advisors, considering alternatives to the transaction and negotiating with the buyer. Make sure affiliates of the buyer (and anyone who might reasonably be influenced by the buyer) are removed from this process. Among other things, keep fulsome minutes (but not detailed transcripts) of meetings. Also, make sure there is strong support for any price approved by the committee.

- Include robust disclosures, including relevant information on price negotiations, when the transaction is presented to the minority stockholders.

Although courts in other states often look to Delaware law for guidance on matters of corporate law, it is not clear that these same principles will apply to corporations domiciled in states other than Delaware.

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11 Op. at 18.

12 *In re Orchard Enterprises, Inc.*, C.A. No. 7840-VCL (De. Ch. 2014)

Application of Entire Fairness Standard of Review to Controlling Stockholder Transactions – *In re: Orchard Enterprises*

In re Orchard Enterprises addresses the application of the entire fairness standard of review to controlling stockholder transactions that employ the procedural safeguards of a special committee approval and a majority-of-the-minority stockholder vote. While upholding the 2013 decision of the Delaware Court of Chancery (the "Court") in *In re MFW Shareholders Litigation* ("MFW"),[13] the Court nonetheless held that the entire fairness standard of review (as opposed to the business judgment rule) applied to a squeeze-out merger effected by a controlling stockholder despite the fact that the transaction was approved by both a special committee and a majority-of-the-minority stockholder vote. *In re Orchard Enterprises* establishes that the mere existence of such procedural safeguards is not sufficient to permit the application of the business judgment rule in cases where the members of the special committee are not disinterested and independent, and the majority-of-the-minority vote is based on disclosures that are materially false or misleading.

In 2010, Dimensional Associates, LLC ("Dimensional") squeezed out minority stockholders of The Orchard Enterprises, Inc., a Delaware corporation ("Orchard"), for merger consideration of $2.05 per share. Prior to the merger, Dimensional and its affiliates held approximately 42% of Orchard's common stock and 99% of its Series A convertible preferred stock (representing approximately 53.3% of Orchard's outstanding voting power). The transaction was approved by a 5-member special committee and a majority-of-the-minority stockholder vote (58%).

After the closing of the merger, certain former Orchard stockholders pursued an appraisal. In 2012, Chief Justice Strine, then Chancellor, determined that the fair value of Orchard's common stock at the time of the merger was $4.67 per share. Thereafter, the plaintiffs, former stockholders of Orchard, filed a lawsuit contending that Orchard and the directors who approved the merger breached their fiduciary duties and should be held liable for damages.

In cross motions for summary judgment, the plaintiffs claimed that (i) the defendants breached their duty of disclosure, that entire fairness is the operative standard of review, and that the merger was not entirely fair, (ii) Dimensional and certain directors breached their duty of loyalty, and (iii) Orchard breached its fiduciary duty.[14] Various defendants challenged the plaintiffs' claims, and argued that neither rescissory damages nor quasi-appraisal were available remedies, and that the special committee members were exculpated from liability based on provisions of Orchard's certificate of incorporation that purport to exculpate directors from liability as permitted by Section 102(b)(7) of the Delaware General Corporation Law.[15]

Entire Fairness Versus the Business Judgment Rule. The Orchard decision, citing *MFW*, confirmed that if a "controller agrees up front, before negotiations begin, that the controller will not proceed with the transaction without both (i) the affirmative recommendation of a sufficiently authorized board committee composed of independent and disinterested directors and (ii) the affirmative vote of a majority of the shares owned by stockholders who are not affiliated with the controller, then the controller has sufficiently disabled itself such that it no longer stands on both sides of the transaction, thereby making the business judgment rule the operative standard of review." The Court further noted that if a controller agreed to use only one of the protections, or did not agree to both protections up front, then the most that the controller could achieve was a shift in the burden of proof such that the plaintiff challenging the transaction must prove unfairness. The Court determined that Dimensional, the controlling stockholder, did not agree to proceed with procedural protections of both an independent special committee and the vote of a majority-of-the-minority prior to the start of its negotiations with the special committee. Based on that determination, the Court held that the entire fairness standard was the appropriate standard of review.

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13 *In re MFW S'holders Litig.*, 67 A.3d 496 (Del. Ch. 2013). Upheld by the Delaware Supreme Court on March 14, 2014 (*Kahn v. M&F Worldwide Corp.*, 88 A.3d 635 (Del. 2014).).

14 The Court granted summary judgment to Orchard on the basis that fiduciaries who serve the entity owe fiduciary duties; the entity that is served does not.

15 The Court determined that the exculpatory clause was a "strong defense", but concluded that it was premature to make a determination under Section 102(b)(7) without first determining whether the transaction was entirely fair, determining whether liability exists and on what basis, considering the evidence as a whole and evaluating the involvement of each of the individual directors.

In addition, the court found that there existed questions of fact as to (i) whether one of the special committee's "most influential" members was disinterested and independent and (ii) whether Dimensional provided misleading information to the special committee regarding transaction negotiations and its intentions with respect to a sale to a potential third party as part of a go shop process. The prospects of lack of independence of a special committee member, and that the special committee was not fully informed and misled by the controlling stockholder, called into question the efficacy of the special committee procedural safeguard and whether the process was fair. The Court determined that it would be impossible to establish entire fairness if it were found that Dimensional misled the special committee. In addition, the decision stated that the use of the special committee safeguard is not sufficient to shift the burden of proof if its members are not truly disinterested and independent.

Disclosure Violations. The Orchard Court also held that the majority-of-the-minority vote to which Dimensional eventually agreed was not sufficient to shift the burden of proof from the defendants because Dimensional did not demonstrate that the vote was fully informed. The Court determined that the proxy statement relating to the squeeze-out merger included at least one false statement that was material as a matter of law and the inaccurate disclosure rendered the majority-of-the-minority vote ineffective to shift the burden of proof from the defendants to the plaintiffs.

Post-Closing Damage Awards. Regarding issues of damages, the Court recognized the possibility of a post-closing damages award for a breach of the fiduciary duty of disclosure in cases where reliance, causation and damages could be established. The Court determined that rescissory damages could be imposed if the merger was determined to be unfair and if one or more of the defendants were found to have violated their fiduciary duty of loyalty; quasi-appraisal damages could be a possible remedy in cases where it has been determined that the transaction was not entirely fair.

Practical Implications and Practice Points

When embarking on a controlling stockholder squeeze-out transaction:

- Procedural Safeguards Must Be Established Before Negotiations Begin: in order to obtain the benefits of the business judgment rule, the controlling stockholder must agree up front, before any negotiations begin, that it will not proceed with the transaction without both (i) the affirmative recommendation of a sufficiently authorized board committee composed of independent and disinterested directors and (ii) the affirmative vote of a majority of the shares owned by stockholders not affiliated with the controller. If both safeguards are not utilized, then the most that a defendant can achieve is a shift in the burden of proof to the plaintiff to establish that the transaction was not entirely fair.
    - *Special Committee Must Be Truly Independent and Disinterested*: the use of the special committee safeguard is not sufficient to shift the burden of proof if its members are not truly disinterested and independent. A pre-existing relationship with the controller or an interest of a special committee member in the transaction (such as post-closing consulting arrangements) may undermine the requirement of independence and disinterestedness.
    - *Controller Candor With Special Committee*: in order to make the special committee function properly, the controller must fully disclose all material facts and circumstances relating to the transaction. If the special committee is misled or not fully informed by the controller, then it will be "virtually impossible" for the controller to establish that the transaction was entirely fair. To obtain the benefit of burden shifting, the special committee must not allow the controller to dictate the terms of the transaction and the special committee must exercise real bargaining power at arms-length from the controller, on a fully informed basis.
- Disclosure to Stockholders; Fully Informed Majority-Of-The-Minority Vote: Disclosure documents provided to minority stockholders, such as proxy statements, must not contain material misstatements or omissions; disclosures required by law are of paramount importance. If the majority-of-the-minority vote is not "fully informed," then the controller will not be able to shift the burden of proof to the plaintiff to establish unfairness. The court's recognition of the prospect for post-closing damage awards in the case of inaccurate disclosures and breach of fiduciary duty emphasizes the need to provide full and fair disclosure to minority stockholders.

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UNITED STATES REGULATORY UPDATES

2014 Revised (Higher) Hart-Scott-Rodino Act Thresholds

The Federal Trade Commission ("FTC") has announced its 2014 jurisdictional and filing fee thresholds under the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended (the "HSR Act"). Due to an increase in gross national product over the past government fiscal year, the new thresholds have increased. The increased thresholds became effective on February 24, 2014, and will apply to all covered transactions filed on or after that date.

The Hart-Scott-Rodino Antitrust Improvements Act Of 1976

The HSR Act provides that, where certain jurisdictional thresholds are met, parties intending to merge or make acquisitions must (absent any applicable exemptions) furnish the Premerger Notification Office of the FTC and the Antitrust Division of the Department of Justice with prescribed information regarding their respective businesses and the proposed transaction, and wait a specified period of time before consummating the transaction. The statutory "waiting period" stays consummation of the transaction for a minimum of 30 days (15 days in the case of bankruptcy or cash tender offers), absent a grant of early termination.

Revised Thresholds

The 2000 amendments to Section 7A of the Clayton Act mandate annual adjustments of the HSR Act thresholds for each fiscal year, that are based on changes in the gross national product. The revised jurisdictional and filing fee thresholds for this year increase the dollar amount limits for the size of transaction and the size of person at which parties to a transaction are required to make an HSR filing, as well as the filing fee thresholds. Many of the other filing requirements related to dollar amounts in the HSR Act have similarly been increased to remain consistent with the revised jurisdictional and filing fee thresholds.

New Jurisdictional Thresholds

UNDER THE NEW JURISDICTIONAL THRESHOLDS, A TRANSACTION WILL BE REPORTABLE IF:		OLD THRESHOLDS
Size of Transaction Test	The Acquiring Person will hold, as a result of the transaction, an aggregate total amount of voting securities, assets and/or interests in noncorporate entities of the Acquired Person valued in excess of **$75.9 million**; AND	**$70.9 million**
Size of Person Test	The Acquiring Person or the Acquired Person has annual net sales or total assets of **$151.7 million** or more, and the other person has annual net sales or total assets of **$15.2 million** or more; or	**$141.8 million** **$14.2 million**
	Transactions that are greater than **$303.4 million** are reportable, regardless of the size of person test above.	**$283.6 million**

New Filing Fee Thresholds

FILING FEE	THE NEW FILING FEE THRESHOLDS ARE AS FOLLOWS:	OLD THRESHOLDS
$45,000	If the aggregate amount of voting securities, assets and/or interests in noncorporate entities to be held as a result of the transaction is greater than **$75.9 million** but less than **$151.7 million**.	**$70.9 million** **$141.8 million**
$125,000	If the aggregate amount of voting securities, assets and/or interests in noncorporate entities to be held as a result of the transaction is equal to or greater than **$151.7 million** but less than **$758.6 million**.	**$141.8 million** **$709.1 million**
$280,000	If the aggregate amount of voting securities, assets and/or interests in noncorporate entities to be held as a result of the transaction is equal to or greater than **$758.6 million**.	**$709.1 million**

Subsequent Acquisitions of Voting Securities

The FTC also adjusted the HSR Act thresholds for subsequent acquisitions of voting securities. The FTC treats acquisitions of voting securities on a cumulative basis. That is, prior acquisitions of voting securities of the same party are included in the valuation of future transactions between the same parties. Whether an HSR filing is required in a subsequent acquisition between the same parties depends on the cumulative value of what the buyer will hold post-transaction, whether the parties made HSR filings in their prior transaction, and whether the parties now cross a higher HSR threshold than that of their prior filing. Note that any prior transaction where an HSR filing was made that involved an acquisition of 50% or more of the voting securities of the target, there is no further filing obligation, period. In other situations where a prior filing was made, if a new transaction between the same parties crosses a threshold above that of the prior filing, a new filing may be required. Below are the relevant revised 2014 thresholds on this subject.

AS NOW REVISED, THE NEW NOTIFICATION THRESHOLDS ARE:	OLD THRESHOLDS
Voting securities valued at **$151.7 million** or more;	**$141.8 million**
Voting securities valued at **$758.6 million** or more;	**$709.1 million**
Voting securities constituting 25% of the issuer's securities if valued at more than **$1,517.1 million**; and	**$1,418.1 million**
Voting securities constituting 50% of the issuer's securities if valued at more than **$70.9 million**.	**$68.2 million**

Section 7(A)(g)(1) of the Clayton Act, 15 U.S.C.

Section 7(a)(g)(1) provides that any person, officer, director or partner thereof, who fails to comply with any provision of the HSR Act is liable for a civil penalty for each day during which such person is in violation. The maximum amount of civil penalty is $16,000 per day.

The FTC (the agency responsible for administering the HSR Act) has often stated that it takes compliance with the HSR premerger notification requirements seriously, that it will not hesitate to seek significant civil penalties from violators, and indeed it has backed this up in recent years with enforcement actions against a variety of defendants (including both companies and individuals). It is therefore important that all parties to a merger, acquisition, or joint venture follow adequate measures to ensure compliance with the HSR Act.

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