M&A Hot Topics
Quarterly Update (January 11, 2017)

1. SEC Updates

- **SEC Issues Universal Ballot Proposal**: The SEC, by a 2-to-1 vote, proposed the mandatory use of universal proxy cards in all contested director elections at annual meetings of listed U.S. public companies. The proposed rule would enable stockholders in contested elections to vote by selecting directors proposed by the issuer and/or the dissident using a single proxy card to fill all available board seats. Comments on this proposal are due by January 9, 2017. Given this timing, it is unlikely that the proposed rules, if adopted, will be effective for the 2017 proxy season. S&C's discussion of the universal ballot proposal is here.
- **Tender Offer Disclosures of Financial Advisor Compensation Arrangements**: The SEC's Division of Corporation Finance released seven new Compliance and Disclosure Interpretations related to the tender offer rules under Sections 14(d) and 14(e) of the Exchange Act. Among other things, the C&DIs clarify certain disclosure requirements under Schedule 14D-9 regarding a financial advisor's compensation arrangements, including that while quantifying the amount of compensation payable to financial advisors "may not necessarily be required in all circumstances," disclosure should include a summary of the types of fees payable to financial advisors and any contingencies, milestones or triggers relating to the payment of the compensation.

2. Selected Regulatory Developments in Recent M&A Transactions

- **CFIUS Blocks Aixtron Deal**: On December 2, 2016, President Obama issued an executive order blocking the sale of the U.S. business of Aixtron SE to a Chinese investor, following a recommendation from CFIUS. President Obama's order is the first time that the President of the United States has blocked foreign investment in a U.S. company prior to closing, and the third time that Presidential action has been taken under CFIUS authority (in the other two instances, the President ordered divestment). In a number of other cases, potential investors have abandoned proposed transactions after CFIUS raised concerns prior to referral of the matter to the President. The proposed investment was in the semiconductor sector, and in this case demonstrates the U.S. government's close scrutiny of both foreign investment in sensitive U.S. industries and inbound investment from the People's Republic of China. This case follows several other proposed investments from Chinese buyers in the semiconductor sector that reportedly have encountered CFIUS objections, as well as a recommendation earlier this month from the U.S.-China Economic and Security Review Commission, a government agency that monitors the countries' strategic and economic relationship, to bar all Chinese state-owned companies from making acquisitions in the U.S.
- **French Gun-Jumping Fine**: On November 8, 2016, the French Competition Authority fined Altice Group EUR 80 million for taking part in certain strategic business decisions of its merger targets and exchanging a significant quantity of commercially sensitive information with the targets before the French Competition Authority had approved the mergers, thus violating the waiting period requirements of French merger control law. This is the highest fine ever imposed for gun-jumping by a competition regulator.
- **MOFCOM Rules That Foreign-to-Foreign Deal Jumped the Gun**: In a decision adopted on December 16, 2016, the Chinese Ministry of Commerce fined Canon for failure to file for merger control clearance for its acquisition of Toshiba Medical Systems. This represents MOFCOM's first failure-to-file decision in a purely foreign-to-foreign transaction.

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3. Tax Developments

- **Significant Tax Reforms Expected**: With the election of a new president and Republican control of Congress, there is increased expectation of significant tax reform at both the individual and business levels. At this time, it is unclear what the final package of tax reform will contain. Broadly speaking, at the individual level, one could expect some broadening of the base (through limiting itemized deductions and the like) and a lowering of rates. For businesses, there is greater uncertainty. While a rate reduction and some shift toward a territorial approach (*i.e.*, away from worldwide taxation) are expected, the campaign proposals of the President-elect and the Republican proposals in the House of Representatives differ in some significant respects. In particular, the Republican House proposal would replace the corporate income tax with a so-called Destination-Based Cash Flow Tax ("DBCFT"). The DBCFT would be similar to a VAT, and would differ from the traditional corporate income tax in at least the following ways: (1) it would be border-adjusted, meaning that exports would not be taxed but imports will be; (2) the tax is on cash flow rather than income (with immediate expensing of capital expenditure and a wage deduction), and (3) net interest expense would not be deductible. The DBCFT would mark a fundamental shift in the taxation of business entities, and important details are still being worked out (*e.g.*, exemptions for financial institutions, how it applies to what are considered to be pass-through entities, whether DBCFT is WTO-compliant). Many constituencies have voiced various degrees of enthusiasm for or opposition to the DBCFT. The impact of these tax-related developments on M&A is yet to be determined.
- **Final Earnings Stripping Regulations Released**: The IRS and the Department of Treasury issued final regulations on earnings stripping on October 13, 2016, replacing the proposed regulations that were issued on April 4, 2016 and were intended to reduce tax benefits associated with inversion transactions. The final regulations generally retain the structure and approach of the proposed regulations, including (i) rules that would recharacterize applicable related-party debt if it fails to meet certain documentation requirements and (ii) rules that would recharacterize applicable related-party debt if it in effect replaces equity capital. However, the final regulations are much narrower in scope than the proposed regulations, including an exclusion for foreign issuers (including subsidiaries of U.S. multinationals) and for financial institutions. S&C's discussions of the final regulations are here and here.
- **New Partnership Disguised Sale Rules**: The IRS issued final, temporary and proposed regulations on October 4, 2016 that change the partnership disguised sale rules and the rules regarding allocation of partnership liabilities. These regulations largely eliminate the benefits associated with tax-motivated leveraged partnership transactions. Significantly, the regulations effectively treat all partnership liabilities (with limited exceptions) as nonrecourse liabilities for disguised sale purposes, limiting a contributing partner's ability to be allocated a disproportionate share of a partnership's debt and thus to receive tax-free cash distributions from a partnership related to a contribution of appreciated property. S&C's discussion of the regulations are here.

4. Corporate Governance

- **First Effort to Use Proxy Access at a U.S. Company Fails**: On November 9, 2016, GAMCO Asset Management Inc. became the first stockholder to use a company's proxy access bylaws to attempt to nominate a director to a public company board. National Fuel Gas Co. rejected the nomination, concluding that GAMCO did not satisfy the company's requirement that an investor seeking proxy access must have acquired its shares "in the ordinary course of business and not with the intent to change or influence control of [NFG]." GAMCO subsequently withdrew its nominee.
- **Institutional Investor Critiques Board Responses to Activists**: State Street Global Advisors recently became the latest large asset manager to outline concerns over board responses to stockholder activism, particularly the risk that companies may take actions that favor the short-term interests of activists at the expense of longer-term results. Among other concerns, State Street identified several red flags for long-term investors in its reviews of the actions of large activists in the last three years, including increasing CEO pay, tying CEO compensation to earnings per share, and undue focus on share buybacks, spinoffs and other financial engineering. S&C's discussion of State Street's commentary is here.

5. Selected Delaware Developments

- **Delaware Court Applies Corwin Decision in Additional Cases**: The Delaware Chancery Court has defined in three cases what constitutes "fully informed" for purposes of the 2015 decision in *Corwin*.
  - In *OM Group*, the Court dismissed the case under the *Corwin* standard, holding that disclosure would not have changed the "total mix" of information available to stockholders and stating that it "generally will deem as immaterial for disclosure purposes a board's decision to shut down negotiations with a potential acquirer that have not produced an offer worth pursuing."
  - In *Comverge*, plaintiffs argued in a summary judgment motion that *Corwin* should not control since stockholders were not fully informed prior to their vote, as (1) the Board was not aware of a carve-out to the acquirer's right to convert its bridge loan into common stock upon a Comverge change of control, and (2) the CEO restricted access to due diligence for an alternative bidder for the Company. The Court found that the omitted information presented a "complex mosaic of factual issues and questions of law" and declined to enter summary judgment, despite the fact that it "doubt[ed] disclosure . . . would have been material in light of the disclosures made in this case."
  - In *Solera*, the Court held that initially the plaintiff bears the burden of identifying deficiencies in the disclosure document. Only if the plaintiff meets that burden does the burden then shift to the defendants to establish that the alleged disclosure deficiency fails as a matter of law . In other words, the defendants do not have to prove a negative and show that the vote was fully informed without reacting to specific alleged deficiencies.
- **Business Judgment Rule Is Standard of Review in Squeeze-Out Merger**: The Delaware Chancery Court confirmed in *Books-A-Million* that, as long as the *MFW* elements for a squeeze-out merger of minority stockholders are met (*i.e.*, the transaction was conditioned *ab initio* on both (i) an independent and empowered special committee that fulfilled its duty of care and (ii) approval of a majority of the minority shareholders in a fully informed, uncoerced vote), the business judgment rule is the operative standard of review. The Court is then "precluded from inquiring into the substantive fairness of the merger and must dismiss the challenge to the merger unless the merger's terms were so disparate that no rational person acting in good faith could have thought the merger was fair to the minority."

- **Stockholder Squeezed Out by a Merger Retains Standing for Direct Claims but Not Derivative Claims**: In *General Electric Co.*, the Delaware Chancery Court explained that when a stockholder is squeezed out by a merger in a transaction in which a breach of fiduciary duty occurred, "the transaction involved necessarily severs the relationship between stockholder and entity." Any *direct* claims arising from the transaction vest in the former owner of the stock, and the former owner retains standing to seek redress for injury. However, the Delaware Supreme Court confirmed in *Brinckerhoff*, in the context of a suit brought by a limited partner in a partnership that was later sold, that *derivative* claims belong to the entity and pass to the entity's successor by operation of law in a merger, causing former unitholders to lose their standing to bring derivative actions.
- **Court Finds Appraised Value Exceeds Deal Price**: In *Dunmire*, the Delaware Chancery Court rejected as flawed the appraisal methods used by experts for both the respondent and the petitioner, and instead relied on its own calculation of discounted net income to determine that the fair value of the shares was 10.7% greater than the sale price. The Court refused to give weight to the merger price, as a single controlling family stood on both sides of a merger, the transaction was not conditioned on the approval of a majority of the minority of stockholders, and the Court expressed concerns that the negotiations were not truly arm's length, despite the establishment of a special committee to negotiate on behalf of minority stockholders.
- **New Examples of Potential Director Conflicts of Interest**: The Delaware Supreme Court found in *Pincus* that a plaintiff raised a reasonable doubt as to the independence of directors based on allegations that one director co-owned a plane with the controlling stockholder and two other directors had interlocking business relationships with him.
- **Delaware Forum-Selection Bylaws Upheld**: On December 12, 2016, a Missouri state court rejected an attempt to circumvent a Delaware forum selection bylaw and dismissed a derivative action by stockholders of Monsanto, who had argued that enforcement of Monsanto's forum selection bylaw would infringe their federal and state constitutional rights because jury trials are unavailable in Delaware Chancery Court.

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