# M&A Hot Topics

## Quarterly Update (July 10, 2018)

### 1. SEC And Stock Exchange Updates

- **SEC Division of Corporation Finance Guidance Clarifies that Forecasts Provided to the Board and Bidders Do Not Require GAAP Reconciliation:** On April 4, 2018, the SEC Division of Corporation Finance issued two new Compliance & Disclosure Interpretations confirming that forecasts provided to the board of directors or bidders in connection with an M&A transaction will not be deemed non-GAAP financial measures requiring GAAP reconciliation. Question 101.02 exempts forecasts provided to a registrant's board of directors or board committee from the definition of non-GAAP financial measures. Similarly, Question 101.03 extends the non-GAAP definition exemption to forecasts exchanged between the parties in a business combination transaction where the forecasts are deemed material and must be disclosed in order to comply with securities laws, especially anti-fraud provisions. This guidance builds on other C&DIs issued in October 2017.

### 2. Other Regulatory Updates

- **Both Houses of Congress Pass FIRRMA Bills to Enhance CFIUS Capabilities:**
  - On June 18, 2018, the Senate passed its version of the Foreign Investment Risk Review Modernization Act of 2018 (FIRRMA) as an attachment to defense appropriations legislation. The bill would expand the statutory definition of "covered transactions" to include foreign non-passive investments in any U.S. critical technology or infrastructure, purchases of real estate located close to ports and other sensitive U.S. government facilities, changes in a foreign investor's rights resulting in foreign control or a non-passive investment in a U.S. business, and any other transaction designed to circumvent CFIUS's jurisdiction. The legislation would also update the definition of "critical technologies" to include newly identified emerging and foundational technologies key to U.S. national security. If the bill is enacted, the initial review process would be extended from 30 to 45 days and up to 75 days under extraordinary circumstances, and a light filing "declaration" process would be created for simpler cases.
  - On June 26, 2018, the House also passed a FIRRMA bill which would alter the scope of transactions subject to CFIUS review and institute fees capped at the lesser of $300,000 or 1% of the value of the proposed transaction to help fund its operations. This bill would no longer expand the committee's jurisdiction beyond acquisitions of U.S. companies to other transaction structures like joint ventures that would result in outbound technology transfers, as the first draft of the bill proposed. Instead, these transfers would be regulated by other government bodies such as the Department of Commerce. The bill would also cover transactions where investors from certain "countries of special concern" would gain access to personal information of U.S. citizens, and would allow CFIUS to consider whether an investment could threaten U.S. jobs and skills that are critical to national security.
- **FTC Issues Guidance on Avoiding Anticompetitive Information Sharing During Merger Negotiations:** On March 20, 2018, the FTC published a blog post on the risks of enforcement actions for illegal information sharing during the premerger process. The FTC highlighted certain information that

could be competitively sensitive, such as current and future price information, strategic plans, and costs, especially where the parties are competitors. Recently, antitrust agencies took action against a hair transplant services company after sensitive information was shared with a competitor performing diligence and against two welded-seam aluminum tube manufacturers that shared sensitive information while competing in a highly concentrated market. The Commission recommended procedural safeguards such as limiting certain information to so-called clean teams of personnel not responsible for competitive planning, pricing or strategy, and using independent agents to handle competitive information. The FTC also advised that disclosing parties should abide by document destruction requirements to reduce the risk of future misuse of competitively sensitive information.

- **European Commission Imposes a €124.5 Million Fine for Gun-Jumping:** On April 24, 2018, the European Commission ("EC") fined Altice, a Netherlands-based cable and communication company, €124.5 million for implementing its acquisition of PT Portugal before receiving regulatory approval. In particular, the EC concluded that Altice (i) acquired the legal right to exercise decisive influence over the target through the purchase agreement's grant of veto rights concerning ordinary course of business matters, and (ii) actually exercised decisive influence in some cases. The fine is the highest ever for violation of EU merger control rules and represents the first time the EC has taken issue with the wording of pre-closing covenants in a transaction agreement. The ruling serves as a reminder for merging parties and their advisors to ensure compliance with applicable merger control rules with respect to pre-closing covenants, integration planning, and information exchanges prior to regulatory approval. The decision may also signal the EC's increased focus on detecting and punishing pre-closing conduct and may lead to increased enforcement by national competition authorities within the EU and beyond. Read more about the impact of the decision in S&C's recent client memo.

## 3. Delaware Developments

- **Chancery Court Defends Its Fair Value Determination Using the Unaffected Stock Price:** On May 21, 2018, in *Verition Partners Master Fund Ltd. v. Aruba Networks, Inc.*, the Delaware Court of Chancery denied a motion for reargument and defended its conclusion that target Aruba's fair value was best represented by its pre-announcement unaffected trading price, which was 30% less than the deal price. Petitioners alleged that the Court "misapprehended the law" through its use of a 30-day average of unaffected trading prices, among other things. The Court pointed to recent Delaware Supreme Court cases *Dell* and *DFC Global* which provided guidance on various appraisal reference points including deal price less synergies, unaffected market prices, and financial analysis by experts. The Court noted the emphasis placed on deal price in these Supreme Court decisions and concluded that the Chancery Court must give weight to unaffected market prices in semi-strong efficient markets. The Court also noted that the fair value determination need not rely on multiple valuation metrics, and that its sole reliance on Aruba's unaffected trading price was justified.

## 4. Developments Outside Delaware State Courts

- **Ninth Circuit Creates Circuit Split by Ruling that Section 14(e) Claims Require Only Negligence:** On April 20, 2018, in *Varjabedian v. Emulex Corp.*, a panel of the Ninth Circuit Court of Appeals departed from five other circuits in holding that tender offer disclosure claims under Section 14(e) of the Exchange Act require a showing of negligence, not scienter. The board of target Emulex filed a recommendation statement in support of a tender offer, which discussed valuations performed by the company's financial advisor in reaching its fairness opinion. However, the proxy omitted a summary of the premia paid analysis which depicted the tender offer as below the average, but within the range, of 17 selected comparable transactions. A shareholder brought suit alleging that omission of the premia analysis summary was misleading. The Court compared the first part of Section 14(e) with the "nearly identical" text found in Section 17(a)(2) and referred to the 1980 Supreme Court decision *Aaron v. SEC*, which found that Section 17(a)(2) does not require a showing of scienter. In contrast, other circuit courts analogized from the Supreme Court's analysis of Rule 10(b)5 to conclude that Section 14(e) required a scienter standard. The Ninth Circuit rejected this reasoning, arguing that Rule 10(b)5 and the related statute were aimed at preventing manipulative and deceptive practices whereas broader concerns animated Section 14(e). This decision may make it easier for plaintiffs to challenge tender offer disclosures in the Ninth Circuit.

- **Tenth Circuit Dismisses Securities Fraud Claim for Failure to Disclose Merger Discussions:** On May 11, 2018, in *Employees' Ret. Sys. of the State of Rhode Island v. The Williams Companies*, a panel of the Tenth Circuit Court of Appeals affirmed the dismissal of securities fraud claims against a company that allegedly failed to disclose merger discussions regarding one of two potential combinations. The Court ruled that because Williams made no statement about the prospect of merging with any company other than WPZ (a company in which Williams owned a majority stake), Williams was under no duty to disclose the discussions with ETE (a competing energy company) to make the statements it made regarding WPZ not misleading. The Court also found that the discussions with ETE were not material since the plaintiffs failed to prove that the discussions would have had a substantial impact on units of any of the three companies. Finally, the Court concluded that the complaint failed to allege that Williams acted with the requisite scienter.

## 5. Activist Investor Developments

- **Washington Court Affirms Board's Right to Reject Nominations and Shareholder Proposals that Violate Advance Notice Bylaws:** On April 3, 2018, in *Blue Lion Opportunity Master Fund, L.P. v. HomeStreet, Inc.*, the Superior Court of Washington for King County denied an activist investor's motion for injunctive relief and affirmed the ability of the HomeStreet board to reject the activist's notice for failure to meet the requirements of the company's advance notice bylaw. Although Blue Lion complied with the bylaw deadlines to nominate directors and submit shareholder proposals at the annual meeting, its notice of intent lacked some required information such as the share ownership of Blue Lion affiliates, certain shareholder representations, and reference to requirements of federal proxy rules. The Court affirmed the validity of the advance notice bylaws and the decision to reject Blue Lion's notice as an exercise of the board's business judgment. The Court also rejected the proposition that "enhanced scrutiny" applied since HomeStreet had not taken any defensive measures. Since the decision, the Washington Department of Financial Institutions Division of Banks determined that the accumulation of proxies in this contest amounted to Blue Lion seeking to exercise a controlling influence over the bank, and that Blue Lion failed to apply for, or obtain, regulatory approval as required under state law for launching such a proxy contest. By May 23, 2018, HomeStreet announced that all three of the board's nominees had been preliminarily elected at the annual meeting even while taking into account Blue Lion's faulty proxies opposing HomeStreet's slate.
- **New York Court Enjoins Shareholder Vote on Xerox-Fujifilm Merger, Leading to Activist Settlement, CEO Resignation, and Buyer Lawsuit:** On April 27, 2018, in *In re Xerox Corp. Consol. S'holder Litig.*, the Supreme Court of New York in New York County issued a preliminary injunction preventing Xerox from holding a shareholder vote on its proposed combination with Fujifilm, through which Xerox would merge with a joint venture owned 75% by Fujifilm and 25% by Xerox. As a result,

Fujifilm would own 50.1% and Xerox shareholders would own 49.9% of the combined company, and Xerox shareholders would receive a $2.5 billion special dividend. Although the board unanimously approved the merger and no other bidder had emerged, the Court focused on the actions of Xerox CEO Jeff Jacobson. While Jacobson was under pressure from two activist investors who were Xerox's first and third largest shareholders, he negotiated the complex merger deal with Fujifilm which included various Xerox governance rights, including a term retaining him as CEO of the combined entity. Notably, the Court ordered Xerox to waive the advance notice deadline to allow one of the activists to nominate an alternative slate of directors at the upcoming annual meeting, finding that the announcement of the business combination qualified as "a material change in circumstances" since the passing of the nomination deadline. Shortly after the ruling, the activists and Xerox entered into an agreement in principle providing for Jacobson's resignation and a board overhaul, but that agreement was quickly terminated due to the failure to execute stipulations discontinuing the activist litigation within two days of signing the agreement in principle. On May 13, 2018, Xerox delivered a termination notice to Fujifilm, citing uncurable covenant breaches and material deviations of certain Fujifilm-Xerox financial statements as bases for termination. Later that day, the activists and Xerox entered into a new settlement agreement providing for the resignation of Jacobson and five other directors, and the appointment of five new agreed-upon directors to a nine-member board. On June 18, 2018, Fujifilm filed suit for breach of contract, alleging, among other things, that Xerox's termination was pretextual and Xerox had willfully breached the transaction agreement. Fujifilm is seeking to prove damages it estimates are in excess of $1 billion, which it says reflect the value its shareholders would have received from the transaction, along with punitive damages, as well as to obtain a declaratory judgment giving Fujifilm the ability to terminate the transactions and collect a $183 million termination fee.

- **Dispute over a Proposed Merger Escalates into Corporate Governance Saga among CBS, a Controlling Stockholder and Other Stockholders:** On May 17, 2018, in *CBS Corp., et al. v. National Amusements, Inc., et al.*, the Delaware Court of Chancery denied a motion by CBS and a special committee of its independent directors for a temporary restraining order to prevent Shari Redstone and National Amusements, Inc. ("NAI") from taking actions to amend the corporate organizational documents or remove the CBS board. The current dispute has its roots in 2016, when Ms. Redstone began to pursue a merger of CBS and Viacom, another NAI-controlled entity and the former parent of CBS. The two sides could not reach an agreement and CBS claimed Ms. Redstone took a series of actions designed to assert NAI's control over CBS and thwart CBS's commitment to independent corporate governance. Through ownership of dual class voting stock, Ms. Redstone effectively controlled 79.6% of the voting power of CBS despite owning only a 10.3% economic stake in CBS. On May 13, after rejecting NAI's most recent merger proposal, CBS scheduled a special board meeting for May 17 to consider issuing a stock dividend, pursuant to powers granted the board in the certificate of incorporation to issue dividends. The dividend CBS contemplated would have diluted NAI's voting power in CBS to 17%, but was conditional on the Delaware court's finding the measure legally and equitably permissible. The justification for the dividend was a concern that NAI would use its voting power to remove the board and force a merger with Viacom that the board believed was not in the non-NAI shareholders' best interests. The board filed a complaint on the morning of May 14, 2018 seeking a declaration that the dividend was appropriate and a TRO preventing NAI from interfering with the board, its composition or any of its decisions (i.e. the dividend) until the Court could rule on the appropriateness of the board's action. However, one hour after the complaint was filed, NAI delivered to CBS consents amending CBS's bylaws to require the approval of 90% of the board to declare a dividend. If effective, this action would have ensured the outcome of the May 17 board meeting because NAI controlled three of the 14 seats on the CBS board. The Court denied the TRO application on the grounds that NAI had not yet taken any actions that were irreparable – the 90% bylaw could still be challenged as could any merger forced by NAI. Therefore, in the Court's view, nothing was about to happen that would cause CBS irreversible injury. Yet, the Court did find CBS's claim of a right to dilute NAI's voting interest "colorable." The Court contrasted CBS's public promises of independent board governance with certain alleged actions of NAI and Ms. Redstone including: putting her personal lawyer on the CBS board; undermining the CBS management team; refusing to agree to typical public company governance measures in a merger with Viacom or to subject the merger to the approval of a vote of a majority of non-affiliated shareholders; deterring other bidders for CBS; and being prepared to remove members of the special board committee put in place to consider a Viacom merger. In denying the motion without ruling on the merits of the claim, the Court cited precedent which endorsed a controller's right to make the first move preemptively to protect its controlling interest. The Court noted that protective, "self-help" actions by Ms. Redstone would not create irreparable harm because such actions would still be subject to judicial review, and the Court, if appropriate, could provide judicial relief in a case where Ms. Redstone breached her fiduciary duty to the minority. Since the ruling, the dispute has unfolded even further:

- Later on May 17, CBS announced that the CBS board declared the dilutive dividend, "conditioned on a final determination by the Delaware courts, including a final decision on or the exhaustion of time for any appeals, that the dividend is permissible."
- CBS postponed its annual meeting from May 18 to August 10, 2018.
- On May 29, Ms. Redstone filed suit alleging CBS improperly attempted to suppress her influence, thereby violating the bylaws.
- On May 31, a large shareholder of CBS filed a complaint against Ms. Redstone and NAI claiming that interference with the stock dividend breached the defendants' implied duty to the minority among other claims.
- The Court set a trial date for the CBS-NAI suit for October 3, 2018.

**See the latest edition of the *S&C Corporate Governance Hot Topics* for more on Corporate Governance considerations.**