M&A Hot Topics

Quarterly Update (May 15, 2017)

1. SEC Updates

- **SEC Announces Enforcement Actions for Inadequate Disclosures:** On February 14, 2017, CVR consented to the entry of a Cease-and-Desist Order, which found that the oil refinery company made inadequate disclosures in SEC filings about "success fee" arrangements with two investment banks retained by the company to fend off a hostile takeover bid. CVR's disclosure stated "[t]he Company has agreed to pay customary compensation for such services." The SEC alleged shareholders were thus unaware of potential conflicts of interest that stemmed from the fee arrangements, namely that the banks could still earn success fees even if the hostile bidder secured control of the company.
- The same day, a group of investors also consented to the entry of a Cease-and-Desist Order, which found that the investors allegedly failed to properly disclose ownership information in five campaigns to influence or exert control over microcap companies. In each of the campaigns, the groups collectively owned more than five percent and sometimes more than 10% of the companies' outstanding common stock, yet the required filings were incomplete, untimely, or altogether absent.

  Both actions were settled without the defendants admitting or denying the findings.

2. Corporate Governance

- **CII Favors Consequential Majority Voting:** On January 5, 2017, the Council of Institutional Investors (CII) issued an FAQ stating that consequential majority voting is "the only approach that places ultimate authority in the hands of the company's owners." Consequential majority voting, which CII identifies as a "best practice," requires an uncontested nominee to receive more 'for' than 'against' votes in order to be elected and establishes a holdover period (90 to 180 days) after which an unelected director may no longer serve on the board. Consequential majority voting is stricter than the form of majority voting with board-rejectable resignation found at most S&P 500 companies, in which an incumbent holdover director who receives fewer 'for' than 'against' votes must offer a resignation to the board, who may then accept or reject it.
- **ISS Updates Proxy Voting Policies:** Institutional Shareholder Services (ISS), the proxy advisory firm, announced updates to its benchmark proxy voting policies applicable to meetings held after February 1, 2017. For U.S. companies, the updates included negative vote recommendations for directors at newly public companies that have classes of stock with unequal voting rights, or that have other materially adverse provisions (such as supermajority voting requirements), absent a reasonable sunset provision; directors at companies that impose undue restrictions on shareholders' ability to amend the company's bylaws (relevant in the few states, particularly Maryland, that permit such restrictions); and non-CEO directors who hold more than five public company board seats (down from six under current policy).

3. Selected Delaware Developments

- ***Corwin* Cleansing Updates:** The Delaware Supreme Court continued to reiterate that the enhanced scrutiny of *Revlon* is more properly exercised in the context of pre-closing injunctive relief.
    - In *Merge Healthcare*, the Chancery Court dismissed plaintiff stockholders' claims that directors on a majority-conflicted Board of Directors at Merge Healthcare, Inc. violated their fiduciary duties. The court found that the sale was approved and cleansed by a fully informed, uncoerced vote by a majority of Merge's disinterested stockholders. The Plaintiffs alleged that the board chairman was a controlling stockholder because he owned 26% of Merge's outstanding shares and had relationships with the other board members such that all but one was "beholden" to him. The court found that even assuming the board chairman was a controlling stockholder, *Corwin* cleansing applied because he did not extract personal benefits separate and apart from his interests as a stockholder.
    - In *Lax v. Goldman, Sachs & Co.*, the Delaware Supreme Court summarily affirmed the Chancery Court's *Volcano* decision that extended "irrebuttable" business judgment protection to unconflicted tender offer mergers. The ruling confirmed that the *Corwin* standard of reducing post-closing review of transactions to business judgment in the face of a fully informed, uncoerced, and disinterested stockholder decision applies whether that decision is by vote or by tender offer. This means that in the absence of waste, the approval of a transaction by a fully informed, disinterested and uncoerced vote will lead to dismissal of any post-closing action.
    - However, Corwin cleansing is not guaranteed. In *Saba Software*, the Chancery Court declined to apply Corwin cleansing, denying a motion to dismiss because the Complaint pled facts allowing for a reasonable inference that the stockholder vote approving the transaction was neither fully informed nor uncoerced. And *Paramount Gold and Silver Corp.* left open the question of whether a post-closing challenge to deal protection devices under *Unocal* would survive if Corwin were applicable.
- **Chancery Court Invalidates Director-Removal Bylaw Requiring Supermajority Vote:** In *Frechter v. Zier*, the Chancery Court held that a bylaw requiring a supermajority (66%) of stockholder votes to remove directors from a board was unlawful. The Court interpreted Section 141(k) of the DGCL, which states that any "director or the entire board of directors may be removed, with or without cause, by the holders of a majority of the shares," to "unambiguously confer" on a majority of stockholders the power to remove directors. However, the Court clarified that its decision applies only to bylaws, as Section 102(b)(4) allows a charter provision to require a higher vote threshold than otherwise required by the DGCL.
- **Buy-Side Financial Advisor Compensation Disclosure Inadequate:** In *Vento*, the Chancery Court preliminarily enjoined a buy-side stockholder vote in a stock-for-stock merger, finding that the general disclosure that the buyer's financial advisor would be compensated for providing financing to the buyer did not provide adequate detail and needed to be updated to include details of the quantum of fees the buyer's financial advisor expected to receive from its role providing acquisition financing.
- **Delaware Supreme Court Confirms Merger Termination Allowed for Failure to Satisfy Tax Opinion Condition:** In *Energy Transfer Equity*, the Supreme Court affirmed the Chancery Court's decision permitting termination of a merger agreement by the acquirer based on the acquirer's failure to obtain a tax opinion from its counsel, which was a condition precedent to the closing. The Court held that the acquirer had met its burden of proving that the failure to obtain the tax opinion did not materially contribute to any alleged breach. Chief Justice Strine, dissenting, wrote that the evidence showed that the acquirer had not fulfilled its covenant to use commercially reasonable efforts to obtain the tax opinion.

- **Delaware Supreme Court Strictly Construes Limited Partnership Agreement in Reviewing a Related Party Transaction:** In *Enbridge Energy Co.*, the Supreme Court reversed the Chancery Court's prior decision, retreating from two prior holdings. The Court (1) reversed itself on its previously established pleading standard for bad faith, making it easier for a master limited partnership unitholder to state a claim for relief, and (2) reversed its previous interpretation of the Limited Partnership Agreement's provisions related to affiliate transactions, which incorporated a "good faith" standard, relying instead on the rule of contract interpretation that prefers specific provisions over more general ones.
- **Possible Breach of Fiduciary Duty to Satisfy Preferred Stockholders:** In *Frederick Hsu Living Trust*, the Chancery Court allowed several claims in a motion to dismiss to move forward, finding that the Complaint adequately pled that the Company's decision to sell two of its four business lines in order to satisfy the preferred stockholders' stock redemption liabilities, moving the Company away from its acquisition strategy and towards liquidation, breached its fiduciary duty.
- **Proposed Amendments to the DGCL:** If enacted, the amendments will be effective August 1, 2017:
    - The amendments authorize the use of "blockchain" or "distributed ledger" technology, which is a collection of replicated, shared, and synchronized digital data geographically spread across multiple sites, rather than relying on a central source, for the maintenance of corporate records.
        - Use of this technology could reduce settlement times for share transfers, including in the M&A context, and could facilitate keeping an accurate record of authorized shares which would streamline proxy voting. A distributed ledger could eventually allow for corporate filings, such as certificates of merger, with the Secretary of State to be made through the blockchain.
        - A recent M&A-related litigation where the use of blockchain technology may have been beneficial is the *In re Dole Foods Co.* stockholder litigation, where the Chancery Court approved a modification to a settlement plan, finding that the original plan was too difficult and costly to implement due to a discrepancy between the number of class shares stipulated to and the number of facially valid shares claimants submitted after settlement.
- The 2017 DGCL amendments also include various technical changes to statutory sections relating to the authorization and execution of mergers and consolidations.

4. Case Developments Outside Delaware

- **New York Diverges from Delaware on Non-Monetary Settlements:** On February 2, 2017, in *Gordon v. Verizon*, the New York Appellate Division approved a non-monetary settlement to a class action, declining to follow the Delaware Chancery Court's approach in the seminal 2016 case *Trulia*, which refused to approve a non-monetary settlement. The First Department found that the parties' proposed corporate governance reform, which mandated an independent valuation if Verizon sold more than 5% of Verizon's assets, was the "most beneficial aspect" of the proposed settlement.
- **Rejection of Efficiencies Defense in Blocked Anthem-Cigna Merger:** On February 8, 2017, the D.C. District Court preliminarily enjoined the $54 billion proposed merger between Anthem and Cigna, the nation's second and third largest medical health insurance carriers, citing anti-trust concerns. The insurance carriers appealed, and on April 28, 2017, the D.C. Circuit upheld the injunction, ruling that the $2 billion in claimed savings or "efficiencies" that would be passed on to consumers did not outweigh the anti-competitive concerns. Judge Kavanaugh dissented, opining that the merger should be saved for the cost savings it would create for consumers. On May 5, 2017, Anthem appealed to the Supreme Court.
- **Privilege Waiver Through Use of Dropbox and Similar Services:** On February 9, 2017, in *Harleysville Insurance Co.*, the Western District of Virginia found that an insurance company waived the attorney-client privilege and work product protection when it put privileged documents on a non-password-protected document-sharing site on the Internet. In document production, the insurance company produced an email to opposing counsel revealing the URL of the claim file. Opposing counsel downloaded the claim file, accessing privileged documents. The court held that the insurance company had failed to take reasonable measures to protect the confidentiality of the material, as the claim file could be accessed through the URL without a password, and thereby had waived attorney-client and work product protection. The court also sanctioned defense counsel for accessing documents that he knew were not meant to be shared with him, but did not disqualify the firm because the now unprivileged documents would be available to new counsel.

5. Other

- **Delaware's Changes to the Merger Litigation Market Have Marked Success:** *The Shifting Tides of Merger Litigation* report found that the initial effect of the 2015 changes to the merger litigation market, which limited attorneys' fees in disclosure-only settlements, has been to decrease the volume of merger litigation, increase the number of cases dismissed, and reduce the size of attorneys' fee awards; however, litigation brought in Delaware also declined substantially, with plaintiffs filing fewer cases in Delaware's Chancery court and more in other states.
- **Claims Under R&W Insurance Increase:** American International Group's report on Representation & Warranty claims insurance found that claim frequency has continued to rise. AIG's 2015 report had found that for policies issued from 2011 to 2014, claims were filed at a frequency rate of one-in-seven (an average of 14% overall); now that an additional year has passed, claims filed on that same group of policies has jumped to a frequency rate of more than one-in-five (an average of 21% overall).