M&A Hot Topics
Quarterly Update (July 7, 2016)

1. “Brexit”

- In a referendum held in the U.K. on June 23, a majority of those voting voted for the U.K. to leave the E.U. While the “leave” vote has no immediate legal effect under either U.K. or E.U. law, the vote heralds the beginning of a negotiation process over the terms of the U.K.’s withdrawal and its future relationship with the E.U. The S&C memorandum discussing the legal implications of Brexit is available here.

- The “leave” vote may have immediate implications for certain buyers trying to complete U.K. acquisitions. According to media reports, the London Stock Exchange’s proposed $30 billion merger with Deutsche Börse is particularly at risk given plans to locate the headquarters of the combined exchange in London. The fall in the pound sterling against the U.S. dollar may also expose U.K.-listed companies to opportunistic takeovers from U.S. and other foreign corporate buyers. The full ramifications of the vote on the M&A market likely will not be known for quite some time.

2. Regulatory Issues in Certain Recent M&A Transactions

- Antitrust: U.S. Attorney General Loretta Lynch recently stated, “The more complex the deal—and the more markets it potentially endangers—the greater our skepticism that divestiture will safeguard competition. And if we believe that no good solution exists, then we will prosecute our suits to the very end.” Many transactions are taking a very long time (sometimes as much as a year or more) to get antitrust clearance, and several recent high-profile transactions failed to secure necessary clearances:
  
  o Staples and Office Depot called off a $6.3 billion merger on May 10, 2016, after a federal judge granted the FTC’s request for a preliminary injunction. Staples paid Office Depot a $250 million termination fee (3.97% of the deal value).
  
  o Haliburton and Baker Hughes announced the termination of their $28 billion merger on May 1, 2016, after opposition from U.S. and European antitrust regulators. Haliburton paid Baker Hughes a $3.5 billion termination fee (10.12% of the deal value).
  
  o Canadian Pacific withdrew its $30 billion offer for Norfolk Southern on April 11, 2016, shortly after the DOJ spoke out against the deal.

- CFIUS: CFIUS has intensified its review of acquisitions, including some transactions in industries not typically associated with national security. In January 2016, CFIUS blocked Philips’ proposed sale of its Lumileds division to a consortium that included Chinese investors, and, in February 2016, China’s Tsinghua terminated an agreement to purchase a 15% stake in Western Digital after CFIUS announced plans to commence a review of the transaction. In late March 2016, a target (Affymetrix) rebuffed a topping bid from a Chinese investor (Origin) in favor of a lower-valued transaction, citing lack of certainty about the CFIUS process as one reason for its decision.
3. SEC Updates

- **Non-GAAP Financial Measures**: The SEC issued new and revised C&DIs regarding the use of non-GAAP financial measures by reporting companies in public disclosures and filings. The SEC staff has also publicly indicated that it intends to increase its scrutiny of non-GAAP financial measures and the number of comments it issues relating to use of these measures by reporting companies. The guidance may change the manner in which management financial projections are presented in proxy solicitation materials and tender offer filings.

- **Private Equity Broker Registration**: The SEC recently settled an enforcement action against Blackstreet Capital Management, a private equity fund advisory firm, and its owner Murry Gunty. The SEC had alleged that the firm acted as an unregistered broker-dealer in connection with “soliciting deals, identifying buyers or sellers, negotiating and structuring transactions, arranging financing, and executing . . . transactions” on behalf of its portfolio companies, and collected fees for doing so. These activities are of a type often conducted by sponsors of private equity funds, and private equity fund managers should assess the risks of performing in-house brokerage services on behalf of portfolio companies without registering as a broker-dealer.

4. Miscellaneous

- **Board Practices**: In a 2016 study of the structure and composition of boards and director attributes among S&P 1500 companies, ISS has found that, for the third consecutive year, well over half of all companies have majority voting standards, including 88% of S&P 500 companies; there has been a significant increase over the last five years in the number of companies holding annual elections for all directors; companies with larger market caps generally have higher levels of gender and racial/ethnic diversity than those with smaller market caps; and there has been a slight increase in the turnover rate of new directors on boards.

- **IRS Regulations Affecting REIT Conversions**: The Treasury Department and the Internal Revenue Service issued temporary and proposed regulations to extend to 10 years the period during which a REIT is subject to corporate-level tax on recognized built-in gain after a REIT conversion and to impose immediate corporate-level tax on corporations that either become REITs or transfer assets to REITs in certain carryover basis transactions within 10 years of a tax-free spinoff. Under the new regulations, any entity that engages in a spinoff or acquires or combines with an entity that has engaged in a spinoff within the past 10 years cannot become a REIT or be acquired by a REIT without triggering a potentially prohibitive tax cost.

- **Financial Advisor Analysis Disclosures**: In Emulex, a U.S. district court found that directors’ decisions regarding the scope of disclosures concerning a financial advisor’s fairness opinions should be reviewed under the business judgment rule. The Court held that Emulex’s directors’ decision to omit a financial advisor’s premiums paid analysis from the company’s 14D-9 disclosures was not an extreme departure from the standards of ordinary care. As a result, the Court held that the plaintiffs failed to prove that the Emulex directors acted with scienter (i.e., with intent or deliberate recklessness) in making such an omission.
5. Selected Delaware Developments

- **Appraisals:** In *Dell*, the Delaware Chancery Court determined that the “fair value” of Dell Inc. was 28% higher than what Michael Dell and Silver Lake Partners had paid, despite the fact that the merger had been approved by a majority of the unaffiliated stockholders after a lengthy, public sale process. The Court gave four primary reasons for finding the sale price did not create a reliable indication of fair value even though the sale process “easily would sail through if reviewed under enhanced scrutiny”:
  
  o Use of an LBO model: The Court opined that, because the bidders were financial buyers, their bidding price reflected a focus on a short-term internal rate of return (IRR) rather than the true value of the company.
  
  o “Valuation gap”: Dell had made $14 billion in acquisitions that had yet to generate results at the time of the merger. Therefore, the market price—which the Court believed reflected focus on short-term earnings—did not reflect an accurate valuation of the company.
  
  o Lack of pre-signing competition: The Court emphasized that the pre-signing process only involved one bidder. Because the pre-signing price served as the basis for the go-shop post-signing, the Court found that the lack of pre-signing competition undermined the final merger price.
  
  o Size and complexity of Dell hindered the go-shop process: Even though Dell had a 45-day go-shop period with a single match right and a low break fee, the Court stated that the size and complexity of Dell hindered the utility of a go-shop process. Furthermore, the perceived informational asymmetry inherent to a management buyout situation presented “different concerns than true arms’ length transactions.”

  The S&C memorandum describing the *Dell* decision is available [here](#).

  Amendments to the Delaware appraisal statute, which will take effect on August 1, 2016, will not have any material effect on the type of appraisal action at issue in *Dell*.

- **Cleansing Effect of Fully Informed Stockholder Vote:** In *Singh*, the Delaware Supreme Court clarified that a fully informed, uncoerced vote of disinterested stockholders will serve in most cases to cleanse any defects in underlying sales processes and limit the degree to which directors may be found liable for post-closing damages. In *Volcano*, the Delaware Chancery Court confirmed the same standard applies to a two-step tender offer.

- **Board Protections:** The Chancery Court held in *Ebix* that defensive bylaws enacted following a settlement with activist stockholders will still be subject to heightened scrutiny under *Unocal*. This ruling heightens corporate boards’ need to strengthen structural defenses before an activist appears, but such actions may themselves draw the attention of activists.

- **Disclosure-Only Settlements:** The Delaware Chancery Court held in *Driscoll* and *Collins* that disclosure-only claims should be resolved post-closing rather than through an expedited pre-closing process. Furthermore, the Court stated that post-closing remedies for disclosure claims will only be awarded if plaintiffs show both that the disclosure claims had merit and that the transaction was underpriced due to the alleged lack of disclosure.

- **Management Projections:** In *Chelsea Therapeutics*, the Chancery Court ruled that the board’s decision to disregard management’s projections, which indicated a higher valuation for the company was warranted, was within “the bounds of reason,” given that, among other factors, (i) the directors were independent and disinterested, (ii) the projections had been disclosed to the potential bidders, and (iii) the company had disclosed to the stockholders that the board had considered using alternative projections.
• **Breach of Merger Agreement**: In Williams, Energy Transfer Equity LP won clearance on June 24, 2016 to abandon its $38 billion planned merger with The Williams Companies Inc. after the Delaware Chancery Court ruled that tax counsel Latham & Watkins LLP was acting in good faith when it declined to issue and crucial tax opinion on the deal. Williams had accused ETE of breaching the merger agreement by using the tax opinion closing condition to back out of the deal and had petitioned the Court to force ETE to complete the takeover. The Court held that, though the transaction became “manifestly unattractive” to ETE after the agreement was signed, “motive to avoid a deal does not demonstrate lack of a contractual right to do so,” and ETE did not materially breach its obligation to undertake commercially reasonable efforts to receive a tax opinion from Latham.

6. **Selected New York Developments**

- **Squeeze-Out Mergers**: In Kenneth Cole Productions, the New York Court of Appeals adopted Delaware’s approach in M&F Worldwide, holding that business judgment is the standard of review for squeeze-out mergers with controlling shareholders, so long as from the outset the transaction is subject to the approval of a well-functioning, independent special committee empowered to select its advisors and reject the transaction, as well as an informed, uncoerced vote of a majority of the minority shares.

- **Common-Interest Doctrine**: The New York Court of Appeals held in Ambac that the common-interest doctrine allows an attorney-client communication disclosed to a third party to remain privileged if it is in furtherance of a common legal interest and is limited to a common interest in pending or anticipated litigation. However, the Court held that communications by parties to a merger after the merger agreement is signed do not qualify because transactional parties already have ample incentive to share information with one another.

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