M&A Hot Topics

Quarterly Update (April 5, 2018)

1. U.S. Tax Reform: M&A Considerations

Comprehensive tax reform enacted in the United States on December 22, 2017 should significantly impact mergers and acquisitions activity going forward.

- The lowered corporate tax rate should positively affect M&A activity by enhancing the after-tax return from transaction synergies. In addition, there should be significantly more cash available for acquisitions of U.S. companies and assets due to the mandatory deemed repatriation of offshore earnings and profits, combined with the 100% dividends received deduction from a U.S. corporation's foreign subsidiaries.
- The new limitation on interest deductibility to 30% of adjusted taxable income could have a significant impact on leveraged buyouts and other debt-intensive deals (especially those in private equity). The use of alternatives to debt, e.g., preferred equity, may become more frequent. The use of preferred partnership interests in Up-C structures may also become more prevalent. Likewise, corporations that may be affected by the interest deductibility limitation would be motivated to structure certain acquisitions as leases, swaps, derivatives, etc., rather than as debt, to avoid interest deductions that exceed 30% of taxable income.
- Details on these and other considerations are available in S&C's client memo.

2. SEC And Stock Exchange Updates

- **SEC Approves NYSE Rule Change on Announcing Material News Immediately After Market Hours:** Beginning on December 7, 2017, the NYSE requires that listed companies issuing material news after the close of trading on the NYSE wait until the earlier of (i) publication of the company's official closing price on the NYSE and (ii) five minutes after the NYSE's official closing time (4:05 p.m. EST), except when publicly disclosing material information following an unintentional disclosure in order to comply with Regulation FD. More details are available in S&C's client memo.
- **SEC Staff Issues Guidance on Shareholder Proposal Exclusions Under Rule 14a-8:** On November 1, 2017, the SEC Division of Corporation Finance published new guidance, Staff Legal Bulletin No. 14I, regarding no-action requests to exclude shareholder proposals under certain Rule 14a-8 exceptions. Among other things, the Division encouraged issuer boards to include in no-action requests the board's detailed analysis of the issues raised by the "ordinary business" and "economic relevance" exceptions under Rule 14a-8.
- **SEC May Revisit "Proxy Plumbing" Issues:** At a PLI securities regulation conference in November 2017, SEC Chair Jay Clayton suggested that the SEC could address the "cumbersome" proxy process for retail investors and low ownership thresholds for shareholder proposals by reopening the "proxy plumbing" concept release, published in 2010, for public comment.

3. Other Regulatory Updates

- **CFIUS Updates:**
  - Congress Considers Expanding CFIUS Oversight – On November 8, 2017, the Foreign Investment Risk Review Modernization Act (FIRRMA) was introduced in both houses of the U.S. Congress. Among other things, FIRRMA would: significantly expand CFIUS's jurisdiction to include transactions that do not necessarily involve acquisition of control over a U.S. business, but that involve transfers of intellectual property, and licensing agreements in critical technologies and critical infrastructure areas; make certain filings mandatory, as opposed to voluntary; increase scrutiny of unspecified countries of "special concern"; lengthen the number of days allowed for CFIUS review; and provide authority for setting a filing fee that would be designed to increase the committee's resources. Congress has held multiple hearings on CFIUS and FIRRMA since the bill's introduction.
  - CFIUS Blocks Transactions with Asian Buyers – Continuing a trend of blocking deals involving Chinese buyers in sensitive sectors, including the attempted acquisitions of Lattice Semiconductor Corp. and the U.S. business of Aixtron SE, CFIUS reportedly would not approve Chinese financial technology company Ant Financial's effort to acquire Moneygram due to concerns over financial and personal data. As a result, Ant Financial paid a $30 million termination fee to Moneygram. CFIUS also blocked a hostile bid by Singapore-based chipmaker Broadcom to acquire Qualcomm in an unprecedented action, issuing an interim order that prevented Qualcomm from holding its annual meeting of stockholders as scheduled. Approximately one week later, President Trump issued an executive order prohibiting the proposed takeover and disqualifying all of the 15 individuals proposed by Broadcom as potential candidates for directors of Qualcomm. Notably, however, CFIUS did permit one Chinese acquisition to go forward this year when it approved Naura Microelectronics Equipment's $15 million acquisition of Akrion Systems LLC, a supplier of wet-processing systems providing surface preparation for the microelectronic, photovoltaic and display industries, announced on January 17, 2018.
  - These developments and continuing trends highlight the need for parties to consider how best to manage the risk of failure to obtain CFIUS approval, whether through related reverse break-up fees or covenants.
- **Hart-Scott-Rodino Act Revised Jurisdictional Thresholds:** Effective February 28, 2018, the premerger reporting thresholds under the HSR Act have been revised, as they are annually, based on the change in gross national product. The minimum size of the transaction has been raised to $84.4 million (from $80.8 million). The size-of-person test now will apply to transactions valued at $337.6 million or less (up from $323 million). For acquisitions that are subject to the size-of-person test, the "$10 million" person must now be a $16.9 million person and the "$100 million" person must now be a $168.8 million person. More details are available in S&C's client memo.

4. Delaware Developments

- **Delaware Supreme Court Sanctions Use of Deal Price for Appraisal:** On December 14, 2017, in *Dell, Inc. v. Magnetar Global Event Driven Master Fund Ltd.*, the Delaware Supreme Court rejected the Delaware Court of Chancery's conclusion that the deal price was not a useful metric for determining "fair value" under Delaware's appraisal statute. The Court suggested that deal price – assuming a reasonable sale process – merits substantial, and perhaps dispositive, weight. More details on this case are available in S&C's client memo.
  - However, in its first major post-*Dell* decision *Verition Partners Master Fund Ltd. v. Aruba Networks, Inc.*, on February 15, 2018, the Delaware Court of Chancery found that target Aruba's fair value was best represented by its unaffected market price before news of the deal leaked, which was 30% less than the deal price. After finding that an efficient market existed for Aruba's stock, the Court concluded that the 30-day average unaffected market price was "more straightforward and reliable" evidence of fair value as a going concern than the deal price, because backing out synergies and agency costs was "messy" and provided ample opportunities for error. In addition, the Court took issue with both parties' DCF analyses and rejected the method altogether, citing the lack of evidence that the market price was unreliable or unavailable – departing from the usual Delaware approach to consider DCF analysis as probative evidence of fair value even where the market is found to be efficient. More details on this case are available in S&C's recent client memo.
  - Shortly after *Verition Partners*, on February 23, 2018, in *In re Appraisal of AOL Inc.*, the Delaware Court of Chancery chose not to rely on deal price in determining fair value, finding that the AOL sale process was not "*Dell* Compliant": sufficiently "unhindered, informed, and competitive." The Court also did not choose AOL's unaffected market price as the best evidence of fair value as the Court did in *Verition Partners*, because neither party had argued that the market price was determinative or presented evidence as to the efficiency of the market for AOL's shares. Instead, the Court examined the DCF analysis presented by AOL of $44.85 per share, adjusted it upward to account for some analytical decisions made by AOL's expert with which the Court did not agree, and concluded that the fair value of AOL at the time of the merger was $48.70 – $1.30 per share less than the deal price of $50. More details on this case are available in S&C's recent client memo.

Delaware courts also continued to develop standards for analyzing fiduciary duties in the recent cases summarized below:

- **Supreme Court Finds Chairman's Objections to Merger Material to Board's Recommendation in Proxy Statement:** On February 20, 2018, in *Appel v. Berkman*, the Delaware Supreme Court reversed the Delaware Court of Chancery to find that the reasons given by the company's founder, largest stockholder and chairman for abstaining from a merger vote based on price and timing were material to reasonable stockholders and would have altered the total mix of information available to stockholders. Thus, the Court concluded, the disclosure in the Schedule 14D-9 that the chairman abstained from the vote – without explaining that he did so because poor management led to a disappointing price and made it the wrong time to sell the company – made the proxy statement misleadingly incomplete. The Court ultimately found that the omission foreclosed a finding that a majority tender was "fully informed" for purposes of entitlement to *Corwin* business judgment review at the pleading stage, reversing the Chancery Court's dismissal of plaintiffs' claims.
- **Supreme Court Affirms Dismissal of Fiduciary Duty Claims Alleging Improper Diversion of Merger Consideration Through Arrangements with Insiders:** On March 15, 2018, in *Kahn v. Stern*, the

Delaware Supreme Court affirmed the Delaware Court of Chancery's dismissal of allegations that defendant directors "acted in bad faith" and in breach of fiduciary duty when approving a merger that involved arrangements with insiders. The plaintiff alleged that two management directors negotiated unique benefits that were not fully "explained" to stockholders, including the right to rollover equity and post-merger employment for one director and better benefits upon terminating employment for the other. The Supreme Court agreed that the pled facts did not support a rational inference that any directors "faced a non-exculpated claim for breach of fiduciary duty on the theory that merger consideration was improperly diverted into payments for two management directors." However, the Supreme Court affirmed the lower court's decision on narrower grounds by stressing that it is not an "invariable requirement that a plaintiff plead facts suggesting that a majority of the board committed a non-exculpated breach of its fiduciary duties in cases where *Revlon* duties are applicable, but the transaction has closed and the plaintiff seeks post-closing damages," pointing to other cases in which independent directors lacked critical information from conflicted fiduciaries or failed to sufficiently oversee conflicted directors.

- **Chancery Court Dismisses Fiduciary Duty Claims Despite Unavailability of Business Judgment Rule under Corwin:** On November 30, 2017, in *van der Fluit v. Yates*, the Delaware Court of Chancery dismissed a post-closing damages claim alleging that target Opower's directors violated their fiduciary duties while negotiating a two-step merger under Section 251(h) of the DGCL. The Court found that the offer documents' failure to disclose that fiduciaries negotiating the transaction would receive post-transaction employment and the right to rollover unvested options amounted to a material omission. Therefore, the Court concluded that stockholders were not fully informed, rendering the business judgment rule under *Corwin* cleansing unavailable.
- **Chancery Court Extends MFW in Dismissing Fiduciary Duty Claim for Dual-Class Company Share Reclassification Deemed a Controller Transaction:** On December 11, 2017, in *IRA Trust FBO Bobbie Ahmed v. Crane*, the Delaware Court of Chancery dismissed a challenge to a share reclassification it deemed a conflicted transaction, applying the business judgment rule due to adequate protections put in place under the *Kahn v. M&F Worldwide* (MFW) framework. NRG Yield, Inc. (Yieldco) had been controlled by NRG Energy (Energy) since its formation, but acquisitions increasingly diluted Energy's voting power, putting its control at risk. Energy proposed that Yieldco recapitalize by issuing new classes of stock pro rata with minimal voting rights to potentially use in future acquisitions. The Court found that because Energy received a unique benefit – the perpetuation of its control – the reclassification was a conflicted controller transaction. However, the Court did not apply the entire fairness standard of review and instead applied the business judgment rule by extending the *MFW* framework from the context of squeeze-out mergers to the controller transaction at issue. The Court found that the transaction met both elements of the *MFW* framework: it was subjected to approval by a special independent committee that fulfilled its duty of care and a "majority of the minority" stockholder vote. The Delaware Supreme Court has not yet ruled on whether the *MFW* framework can be applied outside of squeeze-out mergers.
- **Chancery Court Dismisses Fiduciary Duty Claims Against Minority Stockholder Alleged to Be a Controller:** On October 24, 2017, in *In re Morgans Hotel Group Co. S'holder Litig.*, the Delaware Court of Chancery found that a minority stockholder's exercise of contractual consent rights that could potentially block an acquisition does not, without more, warrant treating the minority stockholder as a controller.
- **Chancery Court Holds That Stockholder Approval of Merger Cannot Form the Basis for Denying Inspection Rights:** On December 29, 2017, in *Lavin v. West Corp.*, the Delaware Court of Chancery rejected defendant West's argument that *Corwin* can stand in the way of a proper demand for inspection under DGCL Section 220, and ordered the defendant to produce the books and records. The Court clarified that while stockholder approval of a transaction forecloses plenary review of the transaction, it

does not impair stockholders' statutory rights to inspect the company's books and records.

Recently, Delaware courts have also issued rulings with noteworthy implications for contract formation and interpretation in the M&A context:

- **Chancery Court Holds That Buyer Could Not Withhold Earnouts for Suspected Fraud Without Express Provisions in the Merger Agreement:** On October 31, 2017, in *Greenstar IH Rep, LLC and Segal v. Tutor Perini Corp.*, the Delaware Court of Chancery held that the plaintiff seller was entitled to earnouts as a matter of law, where buyer Tutor Perini withheld payment after it suspected the earnout calculation was fraudulently inflated. After several years of making earnout payments under the merger agreement, Tutor Perini came to suspect that the seller's former CEO – who later became CEO of one of the target's subsidiaries and an interest holder – supplied false information to raise its reported profits and therefore the earnouts owed. The Court held that Tutor Perini could not withhold an earnout payment on that basis, and should have anticipated such an issue and specifically contracted for its ability to withhold payment based on perceived inaccuracies in the seller's information. The earnout provision as agreed only provided a dispute resolution mechanism where the *seller* objected to the buyer's calculation. This case underscores the need to specify procedures for earnout provisions that consider each party's potential burdens, and highlights the potential issues of relying on information from seller employees who remain employed post-closing and are especially incentivized to receive higher earnouts.
- **Chancery Court Grants Declaratory Judgment and Specific Performance to Appoint Stockholders' Board Nominees Pursuant to an Oral Agreement with the Board:** On December 8, 2017, in *Sarissa Capital Domestic Fund LP, et al. v. Innoviva, Inc.*, the Delaware Court of Chancery held that an oral settlement reached between a group of Sarissa stockholders and the Innoviva board was a valid, binding agreement, and that Sarissa was entitled to specific performance requiring the board to appoint two Sarissa nominees. Expecting to lose a proxy contest to Sarissa, the board authorized its vice chairman to make a settlement proposal to Sarissa and the parties agreed to a deal over a phone call, with plans to later memorialize the deal. When Innoviva later learned it actually had enough votes to win the proxy contest, it called off the deal and proceeded to elect all its nominees at the annual meeting. The Court held that the parties formed a valid contract during the call and that the evidence confirmed sufficient oral manifestations of assent despite the parties' intention to later put the agreement in writing. The Court concluded that specific enforcement was proper because, among other things, money damages would not remedy Sarissa's lost opportunity for board seats and "Innoviva's opportunistic maneuvers to escape its contractual obligations offend basic notions of equity."
- **Chancery Court Rejects Termination Fee Claim Sought by the Same Party Who Terminated the Merger:** On December 1, 2017, in *The Williams Companies, Inc. v. Energy Transfer Equity, L.P. and LE GP, LLC*, the Delaware Court of Chancery dismissed Energy Transfer Equity's (ETE) counterclaim seeking specific performance of a termination fee provision as a result of Williams' alleged breach in informally withdrawing its contractual board recommendation approving Williams' merger with an ETE affiliate. Notably, ETE had already successfully opposed Williams' suit to force consummation of the merger, though on different grounds owing to the lack of a favorable tax opinion condition precedent. Describing ETE's position of seeking a termination fee after terminating the merger as "unlikely," the Court still acknowledged that Delaware is a "contractarian" jurisdiction and analyzed the contract language. Here, ETE argued that Williams breached a provision prohibiting the board's withdrawal or qualification of the contractual recommendation by negatively commenting about ETE's CEO and chairman and expressing pessimism in the press, public filings, and litigation against the CEO/chairman – hence, an informal withdrawal. Williams contended that this provision should be construed to refer only to board resolutions. The Court found that the termination fee provision "carefully define[d]" the recommendation as four distinct recommendations which the board made and affirmed, and never

formally withdrew or modified. Therefore, the Court held that ETE was not entitled to the fee, but preserved the possibility that Williams' actions could be relevant to a separate "best efforts" claim against Williams.

5. Developments Outside Delaware State Courts

- **U.S. District Court Judge Dismisses Section 14(a) Damages Claim Alleging Merger Proxy Disclosures Misled Shareholders About Regulatory Timing:** On October 27, 2017, in *Jaroslawicz v. M&T Bank Corp.*, the U.S. District Court in Delaware dismissed a claim that statements in a merger proxy expressing belief that the company would timely obtain all necessary regulatory approvals were misleading because regulatory issues would have likely delayed the merger in reality. The Court held that such statements were opinions subject to *Omnicare*'s standard, and were furthermore taken outside of the context of other cautionary language which disclaimed assurances.
- **U.S. District Court Judge Dismisses Claims Alleging Projections Noted in Merger Proxy and Fairness Opinion Were False or Misleading:** On January 25, 2018, in *City of Hialeah Employees' Retirement System v. FEI Co.*, the U.S. District Court in Oregon dismissed Section 14(a) claims challenging projections in a merger proxy statement, finding them protected by the Private Securities Litigation Reform Act (PSLRA) safe harbor for forward-looking statements. Management had previously prepared high and low sets of projections which were both included in the proxy statement, and directed its financial advisor to base its financial analysis in the fairness opinion on the lower projections, believing those projections were more reflective of the business. The proxy statement explained the preference for the lower projections and cautioned that the projections were not factual and might materially differ from actual results. In addition to finding the statements protected by the PSLRA, the Court found the cautionary language sufficient for the proxy. The Court also dismissed a claim alleging the fairness opinion was false or misleading due to over-discounting the DCF analysis, finding plaintiffs' allegations of material omissions conclusory due to insufficient allegations that the inputs or assumptions, or the opinion itself, were inaccurate or misleading.
- **California Appellate Court Finds Board, Not CEO, Exculpated from Breach of Fiduciary Duties:** On November 15, 2017, in *Central Laborers' Pension Fund v. McAfee, Inc.*, the California Court of Appeal Sixth Appellate District, applying enhanced scrutiny, held that exculpatory provisions of McAfee's charter protected the outside board of directors but not the CEO-president from a class action claim brought by former shareholders alleging breach of fiduciary duties. The plaintiffs alleged that the CEO failed to inform the rest of the McAfee board of a $50 per share offer he received during a conversation with a senior vice president of buyer Intel, which ultimately resulted in McAfee accepting an offer for $48 per share. At worst, the Court observed, the independent directors would have breached their duty of care in failing to inform shareholders of a higher price that was offered during negotiations, but that would not have led to money damages under the charter's exculpation provision.

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

In addition, see S&C's Review and Analysis of U.S. Shareholder Activism in 2017.