Second Quarter 2013

The Ropes Recap

Mergers & Acquisition Law News

A quarterly recap of mergers and acquisition law news from the M&A team at Ropes & Gray LLP.

Contents

News from the Courts

The Chancery Court Further Advances the "Unified Standard" for Controlling Shareholder Buyouts

In one of the most important decisions from the Delaware Court of Chancery (the "Chancery Court") this year, Chancellor Strine held that the business judgment rule, rather than the more searching entire fairness standard, will apply to controlling shareholder transactions if, from the outset, the merger is subject to both negotiation and approval by a special committee of independent directors fully empowered to say no and approval by an uncoerced, fully informed vote of a majority of the minority investors.

In re MFW arose out of a takeover proposal from the company's controlling stockholder, MacAndrews & Forbes Holdings, Inc. ("M&F"). M&F's initial proposal to the MFW board conditioned its offer on both the approval of a disinterested, fully-empowered special committee and a non-waivable majority-of-the-minority vote in favor of the deal. M&F also informed the MFW board that if the board did not accept its offer, M&F would remain a long-term stockholder of MFW and would not sell into any third party transaction or initiate an alternative attempt at a takeover, including through a tender offer. Shareholders filed suit against MFW and M&F alleging that the deal was unfair and should be enjoined.

The court granted summary judgment for MFW and M&F, rejecting the plaintiff's claim that the Delaware Supreme Court's decision in *Kahn v. Lynch Communication Systems*, required that the deal be closely scrutinized by the court to decide if it was "entirely fair" to minority shareholders. Instead, Chancellor Strine held that the business judgment rule should apply where a controlling shareholder initially conditions a takeover on *both* the support of an empowered and independent special committee and a non-waivable majority-of-the-minority vote provision. Under this deferential standard, the court will not second-guess decisions of independent directors so long as they can be attributed to some rational business purpose. If *In re MFW* survives appeal, the standard of review for freeze-out tender offers (set forth in *Pure Resources* and *CNS Gas*) will now mirror that of a freeze-out merger.

This decision maps a promising path to reduce significantly the litigation risk to controlling shareholders in take private transactions.

Already, the Chancellor's suggested process is being used in controlling party buyout transactions. David Murdoch, Dole Food's CEO and controlling shareholder, has proposed to take the company private in a process that adheres closely to the Chancellor's suggested *In re MFW* framework. (*In re MFW S'holders Litig.*, C.A. No. 6566-CS (Del. Ch. May 29, 2013))

The Unconflicted Board and *Revlon* Duties

On May 9, 2013, the Chancery Court declined to enjoin the proposed merger of Plains Exploration & Production Company ("Plains") with Freeport-McMoRan Copper & Gold Inc. ("Freeport") in which Plains' shareholders would receive cash and stock of Freeport. In doing so, Vice Chancellor Noble rejected the plaintiffs' allegations that the Plains board of directors failed to discharge its *Revlon* duties. The case once again exhibited that the Chancery Court will not second guess the business judgment of a sophisticated, independent board and that there is no "one size fits all" approach on how to sell a company.

The plaintiffs claimed that the Plains board of directors failed to satisfy its *Revlon* duties because it (a) did not organize a special committee to evaluate the potential transaction, (b) did not conduct a pre- and post-signing market check (including by not having a go-shop provision in the merger agreement), (c) allowed the Plains CEO to lead negotiations with Freeport and (d) did not obtain price protection in the form of a collar on the stock component of the merger consideration. The Chancery Court found each of these arguments unpersuasive. It stated that when seven of eight members of a board of directors are independent and disinterested, the need to establish a special committee is obviated. Further, enlisting the Plains CEO to lead the negotiation, under board supervision, was reasonable in this instance despite the potential conflict presented by the CEO negotiating with his possible future employer, because the Plains Board was aware of the conflict and determined that the CEO was "in the best position to advance the interest of the [Plains] stockholders" since he had the best knowledge of Plains' assets, and his significant ownership of Plains stock aligned his interests with shareholders generally. Additionally, the lack of a pre- and post-signing market check was reasonable in light of the fact that the directors had experience and expertise in Plains' industry and that deal protection provisions in the merger agreement were not so onerous as to preclude the emergence of a topping bidder. (*In re Plains Exploration & Prod. Co. S'holder Litig.*, No. 8090-VCN (Del. Ch. May 9. 2013))

Process Makes Perfect

On May 14, 2013, the Chancery Court granted an injunction requiring that Morgans Hotel Group Co. ("Morgans") (a) reinstate its annual meeting and shareholder voting record dates and (b) refrain from moving forward with a strategic transaction with Yucaipa—a private equity firm controlled by billionaire Ron Burkle, one of Morgans' largest creditors and a member of Morgans' board—until the board approved the transaction pursuant to a proper process.

The litigation arose from a proxy contest initiated by Morgans' largest shareholder, OTK, in March 2013. After the proxy contest was announced, the Morgans board attempted to postpone the annual meeting and record dates and to consummate a transaction with Yucaipa. OTK and a Morgans director affiliated with OTK, Jason Kalisman, filed suit, alleging that the board's actions amounted to an improper attempt to manipulate the shareholder base and place stock into

hands friendly to the incumbent directors in order to defeat OTK's proxy contest. Ropes & Gray represented OTK in both its proxy contest and the related litigation.

As part of the proposed transaction, Morgans planned to transfer The Light Group and the Delano Hotel to Yucaipa for its notes, warrants and preferred stock. As a condition to the transaction, Yucaipa agreed to backstop a $100 million rights offering of Morgan stock. To accomplish the transaction, Morgans' poison pill was amended to allow Yucaipa to acquire up to 32% of Morgans' common stock.

In granting the preliminary injunction, Vice Chancellor Laster concluded that Yucaipa and Burkle hold significant influence over Morgans through Yucaipa's contractual veto rights over sale transactions, contractual right to appoint or elect directors and Burkle's personal influence over the board. The court also found that OTK and Kalisman had a reasonable likelihood of establishing at trial that at least six of the eight directors were interested in the transaction due to post-closing board and executive positions and their respective relationships with Yucaipa and Burkle, and that the directors had breached their fiduciary duty of loyalty.

With respect to the board process relating to approval of the proposed transaction, the Morgans bylaws require reasonable notice of board meetings, but Kalisman was only given one day's prior notice of the meeting, with over 350 pages of information provided for such meeting. The court determined that the board did not give Kalisman sufficient notice, particularly in light of the company's past practice of providing directors with over a week to evaluate similar materials. The Vice Chancellor noted that Delaware's board-centric governance model expects that directors will debate and deliberate, holding that even if the board of directors had stitched up the requisite number of votes to approve the deal, a board cannot simply ram through the approval. By not providing Kalisman with sufficient notice, the board deprived him of his rights as a director, deprived all of the directors of the benefit of an open debate on the issues, and deprived the shareholders of the informed judgment of their board.

A month after the injunction was issued, the annual meeting of Morgans' shareholders was held as directed by the court. At that meeting, and after an intense and highly publicized proxy contest, Morgans' shareholders voted overwhelmingly in favor of OTK's slate and removed the board members that had supported the deal with Yucaipa. (*Kalisman v. Friedman,* No. 8447-VCL, 2013 WL 1668205 (Del. Ch. Apr. 17, 2013))

The Limits of *Revlon*

In *Koehler v. NetSpend Holdings Inc.*, Vice Chancellor Glasscock continued a trend of refusing to enjoin deal votes where shareholders are offered a substantial premium. Analyzing a motion to enjoin the deal, the Vice Chancellor held that the NetSpend board of directors likely breached their *Revlon* duties in a single-bidder sale process characterized by (1) the lack of either a pre-signing or a post-signing market check, (2) a "weak" fairness opinion and (3) a decision not to waive "don't ask don't waive" standstill agreements with two private equity investors interested in buying a block of shares from the majority shareholder (even though these private equity

investors expressed no interest in buying the entire company). Nevertheless, the Vice Chancellor declined to enjoin the transaction on the grounds that any harm was monetary and he noted that stopping the deal would deprive shareholders of the opportunity to take a 45% premium at a time when no other suitor had appeared. (*Koehler v. NetSpend Holdings Inc.*, C.A. No. 8373-VCG (Del. Ch. May 21, 2013))

A Duty to Negotiate in Good Faith Gets Enforced

In *SIGA Technologies, Inc. v. PharmAthene, Inc.*, the Delaware Supreme Court affirmed that a contractual obligation to negotiate in good faith is enforceable. In late 2005, SIGA Technologies, Inc. ("SIGA") and PharmAthene, Inc. ("PharmAthene") began discussing a possible merger, but SIGA Technologies insisted the parties negotiate a license agreement first, given its immediate need for cash. After extensive negotiations over a "nonbinding" license agreement term sheet, PharmAthene gave SIGA a bridge loan, and the parties ultimately executed a merger agreement in June 2006. The bridge loan and merger agreement both provided that, in the event of a failure of the merger, the parties would "negotiate in good faith with the intention of executing" a license agreement reflecting the contents of the negotiated, non-binding term sheet.

The proposed merger eventually failed to close and negotiations over the definitive license agreement stalled as SIGA proposed economic terms significantly more favorable to it than those set forth in the license agreement term sheet. For example, SIGA proposed to increase the upfront payment to be received by SIGA from $6 million to $100 million and the milestone payments to be paid by PharmAthene increased from $10 million to $235 million. The Delaware Supreme Court affirmed the Chancery Court's conclusion that SIGA Technologies breached its contractual obligation to negotiate the license agreement in good faith. Since the court found that the parties would have reached an agreement but for SIGA Technologies' bad faith negotiations, the plaintiff was entitled to recover contract expectation damages. This case serves to remind that an agreement to negotiate in good faith should not be entered into lightly and that it may be risky to unilaterally depart from the key agreed terms during a negotiation if an LOI includes a binding good faith negotiation obligation. (*SIGA Technologies, Inc. v. PharmAthene, Inc.*, C.A. No. 2617 (Del. May 24, 2013))

Chancery Court Finds Exclusive-Forum Bylaws Enforceable

In June, the Chancery Court held that exclusive forum bylaws that designate Delaware as the sole forum for litigation concerning the internal affairs of a Delaware Corporation are generally enforceable. Exclusive forum bylaws generally provide that a certain court is the exclusive forum for disputes including derivative actions, breach of fiduciary duty claims, claims arising pursuant to the company's charter or bylaws and other Delaware claims. Corporations adopt these provisions to avoid parallel shareholder litigation in multiple jurisdictions.

In a long-awaited opinion, the Court held that the bylaws are generally enforceable under Delaware General Corporate Law (DGCL) and contract law. Section 109(b) of DGCL provides

that bylaws "may contain any provision, not inconsistent with law or with the certificate of incorporation, relating to the business of the corporation, the conduct of its affairs, and its rights or powers or the rights or powers of its stockholders, directors, officers or employees." Chancellor Strine found that forum selection bylaws govern disputes related to the internal affairs of corporations. The Court further noted that Delaware allows corporations, through their certificate of incorporation, to grant their directors the power to adopt and amend the bylaws unilaterally, and that such bylaws are binding on stockholders. The certificates of incorporation of Chevron and FedEx (the two companies involved in this lawsuit) authorized the boards to amend the bylaws. Thus, the Court noted, when investors bought stock in Chevron and FedEx, they were aware that the board had this power. "As our Supreme Court has made clear, the bylaws of a Delaware corporation constitute part of a binding broader contract among the directors, officers and stockholders [under Delaware law]." As such, the Court found that the forum selection bylaws constituted valid "forum selection" provisions under Delaware law to the same extent as other contractual forum selection clauses.

The decision does not, however, preclude challenges to forum selection bylaws in particular situations, and the plaintiffs may decide to appeal the decision. Suits falling under federal law, including federal securities laws, are likely candidates for exclusion. (*Boilermakers Local 154 Retirement Fund v. Chevron Corporation*, C.A. No. 7220 (Del. Ch. June 25, 2013) (Strine, C.))

The Basket Case

In an opinion denying a motion to dismiss, Delaware's Vice Chancellor Parsons considered the relationship between an indemnification "basket" and the interpretation of "material" in purchase agreements, suggesting that it is at least plausible that the dollar amount of the basket may define "material" for purposes of the agreement generally. (An indemnification "basket" is used in purchase agreements to set a monetary threshold in calculating damages that must be crossed before a party may seek indemnification.)

Practitioners often consider the relationship between these two concepts, and the opinion confirms that parties should be clear in drafting the intent of the basket provision or risk judicial interpretation that may be at odds with the parties' intent. In the dispute, the parties to a stock purchase agreement are contesting an indemnification obligation related to an alleged breach of a material contract by the seller. Since the agreement did not define materiality, the seller argued that materiality should be interpreted according to the relatively high standard articulated in Delaware case law, while the buyer asserted that the agreement's $100,000 claims basket should define materiality in the agreement, even though the basket provision did not mention materiality. In discussing the positions advanced by the parties, Vice Chancellor Parsons stated that the buyer's position was conceivable, noting that such an interpretation would recognize that the parties intended some relationship between the basket and the interpretation of materiality.

Although this case does not resolve whether baskets and similar provisions should define the term "material" even absent an explicit reference to materiality, it serves as a helpful reminder of

the potential interpretation of such provisions in purchase agreements. (*i/mx Information Management Solutions, Inc. v. MultiPlan, Inc.*, C.A. No. 7786-VCP (Del. Ch. June 28, 2013))

Goldman Sachs Wins Dragon Litigation in Massachusetts Federal Court

On June 11, 2013, Goldman Sachs (represented by Ropes & Gray in this matter) prevailed on the remaining claims from the sale of Dragon Systems Inc. ("Dragon Systems") to Lernout & Hauspie Speech Products N.V. ("L&H") that occurred in June 2000. Goldman advised Dragon Systems in the $580 million all-stock merger. The stock received by Dragon Systems' shareholders ultimately became worthless when significant accounting fraud was uncovered at L&H in the late summer of 2000. Holding that Goldman did not violate the Massachusetts Unfair Trade Practices statute. Chief Judge Saris stated that she gave weight to a January 23, 2013 jury decision in favor of Goldman, and thus held that Goldman's conduct did not rise to the level of breaching its statutory obligations under the Massachusetts Unfair Trade Practices statute. (*Baker v. Goldman Sachs & Co.*, No. 09-10053-PBS (D.Mass., June 11, 2013))

News from the SEC

SEC Requires Full Disclosure in Going Private Transactions Involving Controlling Shareholders

On June 13, the SEC announced that Revlon, Inc. ("Revlon") had agreed to pay an $850,000 penalty to settle accusations that it deceived investors in connection with majority-owner Ronald Perelman's 2009 exchange offer. This settlement serves as a reminder that full and fair disclosure is required in connection in Rule 13e-3 going-private transactions.

An SEC investigation found that during a voluntary exchange offer designed to satisfy a debt to its controlling shareholder, Revlon engaged in tactics that resulted in misleading disclosures to minority shareholders. In 2009, Revlon offered minority shareholders the option to exchange common stock for preferred stock. The trustee administering Revlon's 401(k) plan decided that plan members could tender their shares only if a third-party financial adviser made an adequate consideration determination. When the third-party financial adviser found that the consideration offered in the transaction was inadequate, Revlon amended its trust agreement to ensure that the trustee would not share this adverse determination with plan members or the Revlon board, and directed the trustee to allow plan members to tender their shares without any reference to this adverse determination. Although Revlon's board represented in its offering documents that the board's process was full, fair, and complete in determining the fairness of the exchange offer, this adverse determination was not referenced in any public disclosure regarding the exchange offer. The SEC found that Revlon's conduct violated going private disclosure requirements (Section 13(e) of the Securities Exchange Act of 1934 and Rule 13e-3(b)(1)(iii) thereunder). (*In the Matter of Revlon, Inc*., SEC Release No. 69750 (June 13, 2013))

Notable Deals

Shuanghui International Holdings Limited's Acquisition of Smithfield Foods, Inc.

On May 28, Smithfield Foods, Inc. ("Smithfield") entered into a merger agreement with the Chinese food giant Shuanghui International Holdings Limited ("Shanghui"). Shuanghui agreed to pay $34.00 per share in cash for Smithfield, a 31% premium to the closing sale price prior to the deal's announcement. The deal will be subject to approval by the Committee of Foreign Investment in the United States (CFIUS). Although U.S. politicians have publicly raised concerns about the buyout's implications for food safety in the U.S., the deal is considered likely to receive CFIUS approval, given the lack of a nexus between Smithfield's business (pork) and U.S. national security concerns. Notably, the reverse termination fee provision would not be triggered by a CFIUS rejection of the deal. Shanghui has placed an amount equal to the entire reverse termination fee into an escrow account, to be held as collateral and security for the payment of such fee.

The merger agreement also contains a limited go-shop provision that allows Smithfield to initiate, solicit and encourage alternative acquisition proposals from two third parties who previously provided proposals. For any potential bidder other than these two approved parties, however, a standard no-shop provision applies.

SoftBank Increases Its Bid for Sprint

On June 10, SoftBank Corp. ("SoftBank") raised its bid for Sprint Nextel Corp. ("Sprint"). SoftBank proposed its sweetened offer after Dish Network proposed a competing bid in April. As part of the revised proposal, Softbank and Sprint amended their merger agreement to include provisions that would make it difficult for topping bidders (including Dish) to acquire Sprint, including (i) the adoption of a poison pill by Sprint, forcing any topping bidder to go through the Sprint board, (ii) a force the vote provision, which sets a deadline of June 18 for making a topping bid and (iii) requiring that any topping bid be fully financed in order to constitute a "Superior Proposal". Dish ultimately declined to make a topping bid. Ninety-eight percent of Sprint's shareholders present at a June 25 meeting (representing around 80 percent of Sprint's outstanding stock) voted in favor of the deal.

Royalty Pharma Drops Hostile Bid for Elan

Since the First Quarter 2013 edition of the Ropes Recap, RP Management LLC ("Royalty Pharma") increased its tender offer for Elan Corp, PLC, only to drop its hostile effort after a series of events, including litigation over disclosure matters and the ability to challenge a decision from the Irish Takeover Panel. On June 7, Royalty Pharma announced its increased offer of $13.00 per share, with the possibility of an additional $2.50 in contingent value rights

("CVRs") upon achievement of certain developmental targets for Tysabri, Elan's Multiple Sclerosis treatment. Including the maximum amount payable under the CVRs, the offer valued Elan at $8.0 billion, representing a 46% premium over the closing price of Elan shares on the NYSE as of February 22.

Royalty Pharma's initial offer was conditioned on, among other things, Elan's retention of its interest in Tysabri royalties and the rejection by Elan's shareholders of four Elan transactions put forth at a June 17 special meeting. However, prior to the shareholder meeting, Royalty Pharma indicated that it wanted to amend the terms of its offer to keep the offer alive even if the shareholders approved any of the transactions on June 17. Elan disputed the Royalty Pharma amendment, and the Irish Takeover Panel ruled that Royalty Pharma could not amend its offer. Royalty Pharma appealed the ruling of the Irish Takeover Panel to the Irish High Court, which granted a preliminary injunction enjoining enforcement of the Irish Takeover Panel's decision and was scheduled to decide the issue after shareholders approved one of the four proposed transactions of its June 17 shareholder meeting (a proposed share buyback). In the meantime, however, Elan announced that its board had authorized a full sale of the company and invited Royalty Pharma to participate in the sale process. In response, Royalty Pharma dropped its challenge to the Irish Takeover Panel's decision. Thus, according to Irish takeover rules, Royalty Pharma's offer lapsed, and Royalty Pharma cannot pursue another hostile offer for Elan within the next 12 months. Royalty Pharma has not yet indicated whether it intends to take part in the recently announced friendly Elan sale process.

Tax Update

Final Treasury Regulations Present Dealmakers with New Opportunities to Step-Up Inside Tax Basis

On May 10, 2013, Treasury published long-awaited final regulations under Section 336(e) of the Internal Revenue Code of 1986, as amended (the "Code"). Under these new regulations, certain corporations can elect to treat a qualifying sale, exchange or distribution of the stock of its U.S. subsidiary as a deemed disposition by such subsidiary of its assets thereby offering an opportunity to step-up the tax basis in the assets of such subsidiary (the "336(e) Election"). The 336(e) Election is available to qualified stock dispositions (generally taxable transactions that include certain sales, exchanges and/or distributions) of 80-percent of the voting power and value of the target corporation within a twelve-month period to unrelated persons. The 336(e) Election also applies with respect to qualifying dispositions of S-corporation stock. The 336(e) Election can generally be understood to offer the effect of an asset sale when that form of transaction is not pursued while avoiding a second level of tax on the stock disposition.

The 336(e) Election is available for a wider range of transactions than the familiar election under Section 338 of the Code, which provides for deemed asset sale treatment in certain stock purchase transactions involving a single corporate purchaser. The 336(e) Election applies to qualified stock dispositions in the form of sale, exchange, distributions or any combination(s) thereof, including where the stock of the target corporation is acquired or received by multiple acquirers or recipients and regardless of whether such acquirers or recipients are themselves corporations. Careful consideration should be given to the interaction of these new federal rules with applicable state and local tax rules.

Treasury is continuing to consider whether the scope of the 336(e) Elections should be further expanded to apply in the case of related-party transactions, non-recognition transactions (such as Section 351 exchanges or certain tax-free reorganizations) and transactions involving a non-U.S. seller or target corporation.

London Update

Application of the City Code on Takeovers and Mergers to AIM-listed Companies

Overview of key change

With effect from September 30, 2013, a number of changes will be made to the City Code on Takeovers and Mergers (the "City Code"). The City Code regulates the conduct of takeovers of public companies that are registered in the UK, the Channel Islands or the Isle of Man.

The most significant aspect of the proposed changes is that, as of September 30, the City Code will apply automatically to offers for securities in public companies that are registered in the UK, the Channel Islands or the Isle of Man and whose securities are admitted to listing on AIM (or another multilateral trading facility in the United Kingdom, such as the ISDX Growth Market).

At present, the City Code applies automatically to offers for public companies that are registered in the UK, the Channel Islands or the Isle of Man and whose securities are admitted to trading on a regulated market in the UK (for example the Main Market of the London Stock Exchange or the Main Board of the ISDX or on an exchange in the Channel Islands or Isle of Man). By way of contrast, under the current regime, AIM-listed companies that are registered in one of these relevant jurisdictions are subject to the City Code only if the Panel on Takeovers and Mergers, which administers and applies the City Code, is of the view that the company has its place of central management and control in the UK, the Channel Islands or the Isle of Man.

The place in which a company is centrally managed and controlled will typically be a function of where the members of the board of that company are resident from time to time. As a consequence, if board members relocate or if there is a change in the composition of the board, then this may have an impact on whether the members of that company have the protection of the City Code. This inherent lack of certainty has proved problematic for companies, their members and also for potential investors in such companies.

Implications of the proposed changes

The removal of the "residency test" is largely a welcome development that will give greater certainty both to current and potential investors in a company as well as to the board of the company itself. That said, an AIM-listed company that is registered in one of these relevant jurisdictions and that has operated on the basis that it is not centrally managed and controlled in the UK, the Channel Islands or the Isle of Man may need to take steps to ensure that its procedures and constitutional documents are compliant with the City Code with effect from September 30, 2013.

There is no transitional period for the implementation the proposed changes. They will come into effect on September 30, 2013, and will apply with immediate effect to any offer that is on-going at the point; not just to offer processes that are initiated on or after that date.

The residency test is not being removed wholesale from the City Code, and will continue to apply to public companies registered in the relevant jurisdictions, whose securities are admitted to trading on a market other than a UK or EEA regulated market, a UK multilateral trading facility or a stock exchange in the Channel Islands or Isle of Man. The residency test will also apply to public companies that are registered in the relevant jurisdictions whose securities are not traded on any public exchange and also to private companies registered in the relevant jurisdictions that come within the scope of the ten year rule. (The ten year rule is also to be modified as part of the anticipated changes, and will bring private companies within the scope of the City Code, if, amongst other trigger events, the company's securities have been admitted to trading on a regulated market or multilateral trading facility in the United Kingdom or on any stock exchange in the Channel Islands or the Isle of Man in the ten years preceding the relevant time, or, if the company has filed a prospectus with a relevant authority in the relevant jurisdictions in the ten years preceding the relevant time). AIM-listed companies that are registered outside of the relevant jurisdictions will continue to be outside of the scope of the City Code.

Asia Update

Arbitration Clauses in China: An Already Complicated Subject Becomes Even More So

Introduction

A common provision in cross-border M&A and other transactional agreements involving parties based in China is a dispute resolution clause providing that any disagreement which arises among the parties will be submitted to arbitration at the China International Economic and Trade Arbitration Commission ("CIETAC"), which is the best known arbitration body in China. The recent formal splitting of two branches of CIETAC away from the main body, and two conflicting Chinese court decisions on the validity of agreements to submit to arbitration in the two break-away branches, highlight the need to carefully consider which arbitration location is selected. These developments have implications for both existing and new agreements.

Background

There has long been a tendency for overseas parties – whether an acquirer or target – to want any transaction documents involving a Chinese party to be subject to binding arbitration outside of China for the principal reason that offshore arbitration is frequently seen as providing an efficient and level playing field for the parties in comparison to dispute resolution within China. Conversely, parties located in China generally push for dispute resolution in China, often citing the hassle and expense of having to go abroad to participate in a proceeding and an overarching fear of becoming subject to US-style discovery procedures.

These decisions have very real implications, and a number of considerations need to be taken into account including who are the parties involved in the deal, the likelihood of a dispute, the type of disputes that could arise and other factors. While transaction participants often spend considerable time debating these points, Chinese parties usually insist on dispute resolution being conducted within China,[1] in which case CIETAC, as the best known and most established arbitration body in China, becomes an obvious choice of venue.

CIETAC's headquarters are in Beijing, and it has also operated a number of sub-commissions in cities around China, including Shanghai, Shenzhen, Tianjin and Chongqing. Parties often select one of the regional Sub-Commissions to administer any proceeding which may arise for convenience sake if one or both sides of the transaction are physically located near such Sub-Commission. However, a rupture in the CIETAC organization began in May 2012 when CIETAC Beijing introduced new rules which had the effect of shifting more cases – and therefore more fees -- to Beijing and away from the Sub-Commissions. In response, the CIETAC Shanghai Sub-Commission and CIETAC South China Sub-Commission announced

[1] In a March 2011 report published by the U.S. government-sponsored website http://export.gov, it is estimated that approximately 90% of China-related disputes are resolved inside China.

their independence, meaning they would use their own arbitration rules and panel of arbitrators. Those former branches also renamed themselves the Shanghai International Arbitration Centre ("SHIAC") and Shenzhen Court of International Arbitration ("SCIA"), respectively. CIETAC, SHIAC and SCIA have since been embroiled in a very public battle over, among other things, the legality of the separation and the authority of the break-away branches to accept and hear cases.

Against this messy backdrop, two recent PRC court decisions have contributed to confusion over the enforcement of CIETAC related arbitration clauses. In one case,[2] the parties in a commercial dispute had previously agreed to submit any disagreement to "CIETAC (place of arbitration: Shanghai, China) to arbitrate the case." The dispute was submitted to the former Shanghai Sub-Commission of CIETAC before it had declared independence, but the arbitral award was made after the separation. When one party sought to enforce the award in the Intermediate People's Court of Suzhou in Jiangsu province, the court ruled that although the Shanghai Sub-Commission had jurisdiction over the case when it was initiated, the newly independent SHIAC was not the arbitration body originally selected by the parties. Accordingly, SHIAC had no authority to render an award. This decision directly conflicts with a decision several months earlier by the Intermediate People's Court of Shenzhen in Guangdong province.[3] In that case, the parties had agreed to arbitration at the South China Sub-Commission of CIETAC, and the court determined that although SCIA had declared independence, it had jurisdiction to accept the case and render an award.

Implications for Drafting Arbitration Clauses in Transaction Documents

The dispute between CIETAC, SHIAC and SCIA is still playing itself out, and its full ramifications remain uncertain. Nonetheless, there are a few important contract drafting points to bear in mind:

- **Existing Agreements:** It is not uncommon for existing agreements to state that any arbitration proceeding shall be administered by CIETAC pursuant to its rules and then name the place of arbitration such as Shanghai or Shenzhen (or other locale where CIETAC has a branch). Prior to the rupture within CIETAC, that type of provision was considered adequate to make clear that the case would be held at the local Sub-Commission per CIETAC rules. Now, however, if the parties in that situation submit a dispute to SHIAC or SCIA in lieu of the former Sub-Commissions or instead submit to CIETAC in Beijing on the theory that the Sub-Commissions no longer exist, then there is a possibility that any arbitral award may be denied recognition because the parties had not selected such venues and therefore they lacked jurisdiction. Thus, while reopening discussions over contract terms may not be appealing for a host of practical reasons,

[2] *CSI Cells Co., Ltd. v. Jiangxi LDK Solar Hi-Tech Co., Ltd.*, Suzhou Intermediate People's Court of Jiangsu Province, (2013) *Suzhongshangzhongshenzi* No. 0004.
[3] Civil Order (2012) Shenzhongfashewaizhongzi No.226.

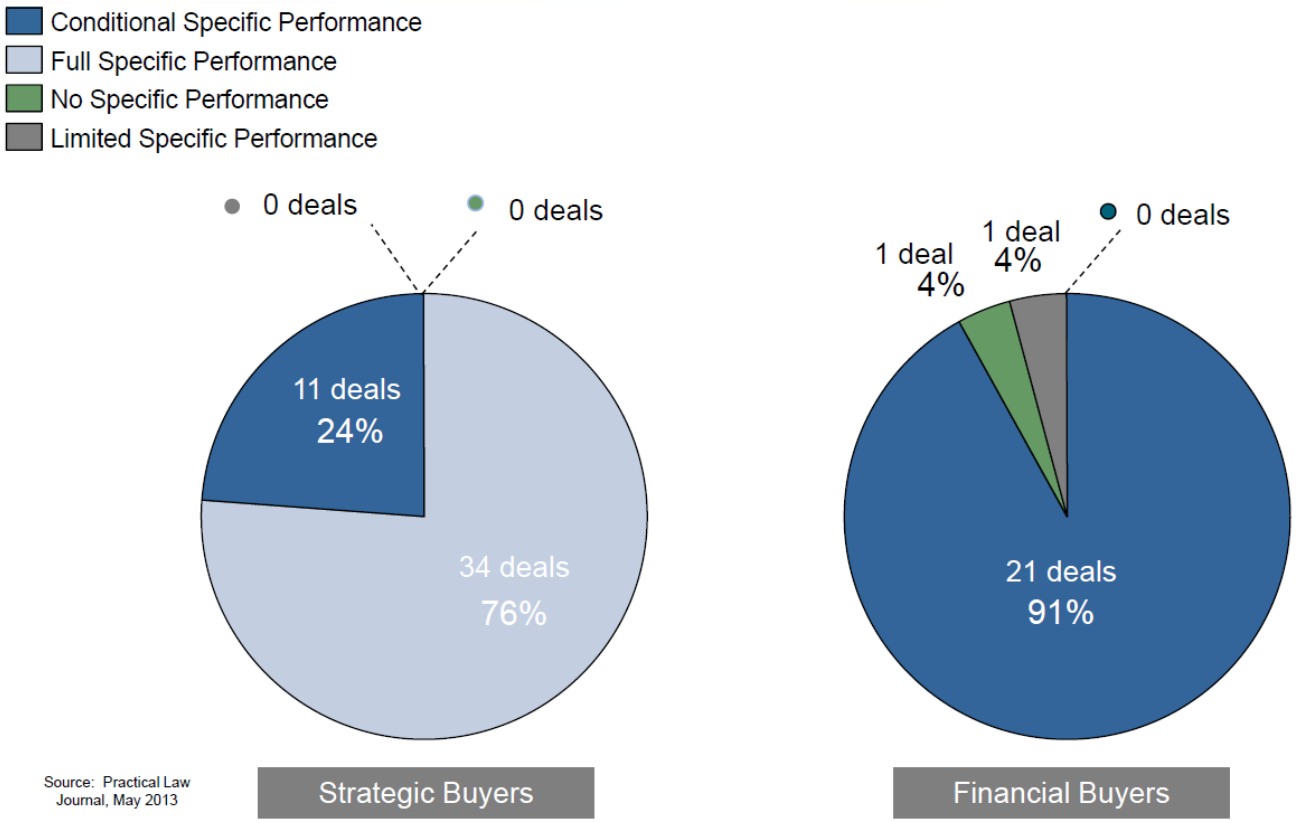
parties should consider proactively clarifying the arbitration provisions, particularly if the contract has a long duration and high risk of disputes arising.

- **New Agreements:** The CIETAC dispute and the inherent uncertainty it creates should provide parties who would prefer arbitration outside of China, such as the Hong Kong International Arbitration Center or the ICC Court of Arbitration, with additional ammunition in their negotiations going forward. If parties choose instead to keep arbitration within China, then the contractual arbitration clause must be drafted more precisely than had previously been market practice, designating the exact institution, venue and rules that apply.

Deal Stat Snapshot

In looking at 68 deals over a one-year period, it is increasingly clear that financial buyers and strategic buyers have vastly different risk tolerance for accepting the remedy of specific performance.

In the chart below, Full Specific Performance indicates that the target company had an unconditioned remedy of specific performance to enforce all of the buyer's obligations. Conditional Specific Performance indicates that the target company could enforce the buyer's obligations to draw down the financing and close the deal, conditioned on the availability of debt financing. Limited Specific Performance indicates that the target company had a right to enforce the financing (but no right to enforce the buyer's obligation to close the deal), conditioned on the availability of debt financing.



Source: Practical Law Journal, May 2013

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