July 2014
Second Quarter 2014

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

Delaware Legislative Update ... 3
Delaware Supreme Court Upholds Facial Validity of Fee-Shifting Provisions in Bylaws of Delaware Non-Stock Corporation ... 3
News from the Courts ... 5
Court of Chancery Analyzes Allegations of Divided Loyalties Among Target Company's Directors and Officers ... 5
Stockholder Plaintiffs Must Allege "Extreme" Facts to Sustain *Revlon* Process Claims Against Disinterested Directors ... 6
Despite Favorable Ruling, Sotheby's Settles With Activist Investor ... 6
Appraisal Decisions: Deal Consideration as Fair Value ... 7
California State Court Follows Delaware on Forum Selection Clause in Bylaws ... 8
Where Fiduciary Duties are Eliminated, Implied Covenant of Good Faith does not give GP a Duty to Disclose ... 8
Report Shows Continued Ubiquity of Stockholder M&A Litigation ... 10
U.S. Supreme Court Upholds Fraud on the Market Securities Class Actions and Largely Preserves the Status Quo ... 10
Tax News ... 13
Corporate Expatriations/Inversions Continue to be Considered by U.S. Companies ... 13
Notable Deals ... 14
Hillshire/Pinnacle Deal Terminated in Favor of Tyson/Hillshire Deal ... 14
Strategic Bidder and Activist Investor Team Up to Target Allergan ... 14
London Update ... 16

England and Wales Court of Appeal Upholds UK Competition Commission's Authority to Bar Transaction Between Two Non-UK Corporations 16

Contributors 18

Delaware Legislative Update

Delaware Supreme Court Upholds Facial Validity of Fee-Shifting Provisions in Bylaws of Delaware Non-Stock Corporation

On May 8, 2014, the Delaware Supreme Court sitting *en banc* unanimously decided *ATP Tour, Inc. v. Deutscher Tennis Bund (German Tennis Federation)*, No. 534 (2013) (Del. May 8, 2014). The court held that fee-shifting provisions in the bylaws of a Delaware non-stock corporation are on their face valid and are enforceable against members who joined before their adoption. The Court further stated that adopting fee-shifting provisions with an intent to deter litigation would not necessarily render such bylaws unenforceable. The Court's conclusion logically extends to Delaware stock corporations, as its analysis draws upon case law concerning Delaware stock corporations and the Delaware General Corporation Law (DGCL) and describes bylaws as a contract between a company and its investors (under which the typical American Rule that each party bear its own attorneys' fees and costs could be modified).

Background

ATP Tour, Inc. (ATP), a Delaware membership corporation, operates a global professional men's tennis tour. ATP's members include entities which own and operate tennis tournaments, and tennis players. Two entities, Deutscher Tennis Bund (DTB) and Qatar Tennis Federation (QTF) joined ATP in the early 1990s and agreed to be bound by its bylaws, as amended from time to time. In 2006, ATP's board of directors amended ATP's bylaws to add a provision stating that if a current or former member initiates litigation against ATP, and "does not obtain a judgment on the merits that substantially achieves, in substance and amount, the full remedy sought," then the member initiating litigation would be obligated to reimburse ATP for any fees, costs and expenses incurred by ATP in connection with such litigation. In 2007, these entities challenged a decision made by ATP, suing the company and six of its seven directors in the U.S. District Court for the District of Delaware. The plaintiffs lost their claims on the merits, and ATP moved to recover its fees, costs and expenses pursuant to the new fee-shifting provision. The District Court certified questions concerning the validity and enforceability of fee-shifting bylaws to the Delaware Supreme Court, which found such bylaws to be facially valid.

Key Takeaways

Shifting Litigation Costs Shifting the cost of defending litigation to unsuccessful plaintiffs could decrease the frequency of shareholder litigation against Delaware corporations and mitigate the significant costs, monetary or otherwise, of shareholder litigation. However, such measures may also have the unintended effect of discouraging meritorious litigation.

Potential Delaware Legislative Response In response to the Court's decision, the Delaware State Bar Association proposed an amendment to the DGCL that would effectively overrule the Delaware Supreme Court's ruling. The amendment aimed to limit the applicability of the holding to only non-stock corporations and limit the imposition of monetary liability by

Delaware corporations on stockholders through charter or bylaw provisions. As a result of lobbying efforts by several Delaware headquartered corporations, the Delaware legislature has tabled until early 2015 discussion of the proposed amendment.

Amending Bylaws In the interim, boards of directors of both public and private Delaware corporations may seek to amend their bylaws to adopt fee-shifting provisions, either in the form permitted by the *ATP Tour* decision or an alternative that seeks to take into account the potential legislative response to the decision. Given the current uncertainty at the legislature, such provisions run the risk of being rendered invalid by future legislative action. Delaware corporations must also consider the possibility that activist stockholders may try and adopt provisions that oppose or restrict any fee-shifting construct. Boards should consider the corporate environment in which such provisions are adopted and how stockholders and proxy advisory firms may react and whether it may be seen as an anti-corporate governance maneuver.

Applicability of Fee-Shifting Provisions Even if valid on their face under Delaware law, fee-shifting bylaws may not be viable in every circumstance. Federal law could preempt Delaware law with regard to the enforcement of fee-shifting provisions in connection with federal law based claims (e.g. in the context of antitrust actions), other states may have different rules regarding fee-shifting, and other courts may apply non-Delaware law in interpreting or enforcing a fee-shifting bylaw leading to unintended results. Finally, the circumstances at the time of adoption of a fee-shifting bylaw may affect the enforceability thereof, for example, if adopted in the face of an active claim the bylaw may be seen as an impermissible attempt at entrenchment.

News from the Courts

Court of Chancery Analyzes Allegations of Divided Loyalties Among Target Company's Directors and Officers

In *Chen v. Howard-Anderson* (C.A. No. 5878-VCL (Del. Ch. Apr. 8, 2014)), Vice Chancellor Laster of the Delaware Court of Chancery evaluated allegations that a target company's directors and officers breached their fiduciary duties in connection with a change-in-control transaction by favoring the winning bidder, which favoritism caused other bidders (who may have been willing to pay a higher price) to avoid the sale process.

This action arose in connection with Calix, Inc.'s 2010 acquisition of Occam Networks, Inc. The plaintiffs alleged that director-affiliated investment funds holding approximately 25% of Occam's stock had conflicting loyalties and that Occam's senior officers showed favoritism to a bidder that confirmed its willingness to honor management's change in control agreements and monetize their equity awards. In evaluating at the summary judgment phase whether Occam's directors breached their fiduciary duty of loyalty, the Court held that the plaintiffs needed not only to establish that the affiliation with the investment funds presented a potential conflict but also to provide evidence supporting an inference that the directors "made decisions that fell outside the range of reasonableness for reasons other than pursuit of the best value reasonably available." In doing so, the Court rejected the defendants' attempt to invoke the standard set forth in the Delaware Supreme Court's *Lyondell* decision, namely that to subject independent directors to liability under the good faith aspect of the duty of loyalty a plaintiff must show that such directors "utterly failed" to satisfy known duties. The Court held that the "utterly failed" standard for bad faith applies only to claims that directors had consciously disregarded known duties, not to claims (as in this case) that directors acted with a purpose other than advancing the best interests of the corporation.

However, in applying the relevant standard, the Court concluded that the directors did not breach their duty of loyalty in connection with the sale process. Vice Chancellor Laster concluded that even if there is the potential for a director to have divided loyalties, there is no conflict if the interests of the director's affiliates are aligned with those of the common stockholders.

Occam's senior officers fared less well on summary judgment, even though the alleged conflict only related to fairly standard change of control benefits the officers would receive in a potential acquisition transaction. The Court rejected the officers' motion for summary judgment, noting that the record showed that the bidder to whom the officers showed alleged favoritism was "willing to confirm that it would honor management's change in control agreements and monetize equity awards."

Stockholder Plaintiffs Must Allege "Extreme" Facts to Sustain *Revlon* Process Claims Against Disinterested Directors

A recent decision from the Delaware Court of Chancery (*Houseman v. Sagerman*, C.A. 8897-VCG (Del. Ch. Apr. 16, 2014)) dismissing stockholder plaintiffs' claims concerning an allegedly defective sales process illustrates the high bar that the Court will apply to *Revlon* process claims against a disinterested board. In *Houseman*, the Court rejected the plaintiffs' claims that the directors of Universata, Inc. breached their fiduciary duties by administering an inadequate sale process in connection with the sale of Universata to HealthPort Technologies, LLC, during which the Universata board did not obtain a fairness opinion in support of the transaction.

In 2010, HealthPort and at least one other potential acquirer approached Universata regarding a potential transaction. The Universata board retained KeyBanc Capital Markets, Inc. to advise the board in connection with the deal. Concerned with costs, Universata's board limited the scope of KeyBanc's engagement and did not request a fairness opinion from KeyBanc. Nevertheless, Universata's board approved the transaction in which HealthPort acquired all of Universata's outstanding stock.

Vice Chancellor Glasscock rejected the plaintiff's claims of a defective sales process, stating that while the board "did not conduct a perfect sales process," the board did not "utterly fail to undertake any action to obtain the best price for stockholders." Indeed, the Court held that the board had fulfilled its duty of loyalty by consulting with legal and financial advisors, considering offers from various bidders, and negotiating with HealthPort. That deferential standard shows that stockholder plaintiffs need to allege sufficiently "extreme" facts in order to discredit a sale process conducted by a board consisting of a majority of independent directors.

The plaintiffs also brought aiding and abetting claims against KeyBanc, asserting that KeyBanc was liable for the defective sale process because it failed to issue a fairness opinion or otherwise administer an appropriate process. In evaluating that claim, the Court confirmed Vice Chancellor Laster's holding from *In re Rural Metro Corp.* that a corporation's exculpation provision will not immunize financial advisors or acquirors from aiding and abetting liability. However, the Court concluded that the plaintiffs had failed to allege that KeyBanc "knowingly participated" in any wrongdoing by the Universata board, rejecting the claim that KeyBanc's limited engagement was improper or constituted knowing participation in any purported breach of fiduciary duties by the Universata board.

Despite Favorable Ruling, Sotheby's Settles With Activist Investor

The Delaware Court of Chancery declined to invalidate Sotheby's adoption of a two-tiered stockholder rights plan (poison pill) with a lower trigger for activist investors. The Sotheby's board subsequently settled with the activist investor the poison pill was meant to deter.

On May 2, 2014, Vice Chancellor Parsons declined to overturn a poison pill that would limit activist investors to holding no more than 10 percent of Sotheby's shares, while permitting passive investors to hold as much as 20 percent. The Sotheby's board adopted this plan in October 2013 after learning that activist investor Third Point Capital LLC had accumulated just under 10 percent of Sotheby's stock. As noted in the Q1 2014 edition of the *Recap*, Third Point subsequently filed suit against Sotheby's seeking to invalidate Sotheby's poison pill. Third Point also launched a proxy contest to name three of its designees to Sotheby's board and sought a preliminary injunction to delay Sotheby's annual stockholder meeting.

Applying the Court's heightened standard of review from *Unocal Corp. v. Mesa Petroleum Co.* with respect to defensive tactics, Vice Chancellor Parsons declined to enjoin Sotheby's annual meeting and determined that the rationale behind Sotheby's stockholders rights plan was both reasonable and proportionate to the threat posed by activist investors. As part of its analysis, the Court accepted the notion that a "wolfpack" of activist investors who form together for the purpose of jointly acquiring large blocks of a target company's stock could pose a legally cognizable threat to stockholders.

Vice Chancellor Parsons also noted that there was a substantial possibility that Third Point would win its proxy contest, making any preliminary intervention by the Court unnecessary. At the time of the Court's decision, Third Point had already won the support of Sotheby's third-largest stockholder, another activist investor, as well as support for two of its three nominees from ISS.

Notwithstanding Vice Chancellor Parson's decision, Sotheby's announced on May 5, 2014 an agreement to appoint Third Point's three designees to the board and to allow Third Point to increase its equity stake in Sotheby's to 15 percent. The settlement is one in a growing trend of recent settlements with activist investors. (*Third Point LLC v. Ruprecht*, C.A. 9469-VCP (Del Ch. May 2, 2014)).

Appraisal Decisions: Deal Consideration as Fair Value

In Delaware appraisal actions, as we reported in the Q1 2014 edition of the *Recap*, the Delaware Court of Chancery has recently shown a willingness to look to deal consideration in arm's-length transactions as the best indicator of fair value, breaking from the Court's tradition of using discounted cash flow to determine a company's value. Two recent decisions confirmed this trend but also showed the limitations on the Court's willingness to use deal consideration as a value measure. In *Huff Fund Investment Partnership v. CKx, Inc.* (C.A. 6844-VCG (Del. Ch. May 19, 2014)), a case in which the Court had previously ruled that the merger price paid by the acquirer was the best available measure of the target's value, the Court held to its ruling and denied motions by both parties to adjust the appraisal determination in light of (among other factors) a post-merger acquisition by the target, unexploited revenue opportunities and certain cost savings realized by the acquirer in taking the target private. In contrast, in *Laidler v. Hesco Bastion Environmental* (C.A. 7561-VCG (Del. Ch. May 12, 2014)), a case in which a company's majority shareholder conducted a tender offer and subsequent short-form merger to acquire full

control of the company, the Court made clear that this same deference will not be afforded to interested transactions and instead fashioned its own calculation of the fair value of the petitioner's shares based on a direct capitalization of cash flows.

California State Court Follows Delaware on Forum Selection Clause in Bylaws

State and federal courts in California have gone different directions on whether to follow Delaware's lead in enforcing forum selection provisions in bylaws. In 2011, the Northern District of California had ruled in *Galaviz v. Berg* that a forum selection provision in Oracle's bylaws was not enforceable. However, in a recent case, the Superior Court of California followed the Delaware Court of Chancery's 2013 decision in *Boilermakers v. Chevron,* in which the Court of Chancery upheld the enforceability of a forum selection bylaw. The California Superior Court dismissed shareholder class actions against Safeway arising from its announced merger on account of a provision in Safeway's bylaws designating Delaware as the exclusive forum for such cases. In its decision, the Court noted that *Galaviz* had been decided before *Chevron*, and that (in contrast to *Galaviz*) there was no evidence that the alleged wrongdoing had occurred before Safeway adopted its exclusive forum bylaw.

However, in a less favorable development for enforcement of exclusive forum bylaws, the Northern District of California declined to certify the enforceability of such bylaws to the Delaware Supreme Court. This ruling denies the defendant corporation the chance to argue this issue in front of what would likely be a sympathetic tribunal, given the Delaware Supreme Court's decision in *ATP* (see *Delaware Legislative Update* above) regarding fee-shifting provisions in bylaws, and given that Chief Justice Strine authored *Chevron* while on the Court of Chancery. (*Groen v. Safeway*, No. RG14716641 (Cal. Super. Ct. May 24, 2014); *Bushansky v. Armacost*, 3:12-cv-01597 (N.D. Cal. June 25, 2014)).

Where Fiduciary Duties are Eliminated, Implied Covenant of Good Faith does not give GP a Duty to Disclose

The Delaware Court of Chancery issued a decision (*In re El Paso Pipeline Partners, L.P. Derivative Litigation*, C.A. No. 7141-VCL (Del. Ch. June 12, 2014)) reiterating the limited scope of the implied covenant of good faith and fair dealing where a limited partnership had explicitly eliminated fiduciary duties under its limited partnership agreement.

El Paso Corporation had formed a controlled entity, El Paso Pipeline Partners, L.P., which was intended to acquire assets over time from El Paso. Because such transactions presented a potential conflict of interest, the Pipeline Partners LP Agreement provided that it could proceed with the transaction only with the approval of its Conflicts Committee. In the transaction at issue, the Conflicts Committee approved El Paso's sale of certain assets to Pipeline Partners, but later discovered that El Paso did not disclose that it had declined to exercise a right of first refusal to acquire similar assets from a third party at a lower valuation. The shareholder plaintiffs alleged, among other things, that El Paso's failure (through its control of the GP of Pipeline Partners) to

disclose potentially relevant information to the Conflicts Committee violated the implied covenant of good faith and fair dealing.

Vice Chancellor Laster granted the defendants' motion for summary judgment, placing considerable weight on the fact that the LP Agreement expressly eliminated all fiduciary duties. Noting "[w]hen an alternative entity agreement eliminates fiduciary duties as part of a detailed contractual governance scheme, Delaware courts should hesitate to use the implied covenant to reconstruct the outcome that fiduciary duty analysis would have generated" and that "if the drafters intended for a disclosure obligation to exist, they would have included specific language," the Court declined to "gap fill" its way to an implied duty of disclosure.

Court of Chancery Declines to Apply *MFW* Standard Where Plaintiffs Allege Controlling Stockholder Coerced Minority Vote

Ruling from the bench, Vice Chancellor Laster declined to dismiss allegations that Sprint Nextel Corporation, formerly the controlling stockholder of Clearwire, used its controlling position to force an unfair deal onto minority stockholders when it acquired the remaining shares of Clearwire in July 2013. In allowing these claims to proceed, Vice Chancellor Laster refused to apply the business judgment standard of review to the transaction under *Kahn v. M&F Worldwide Corp*. ("*MFW*") at the motion to dismiss stage of the proceedings given allegations that cast doubt as to whether all the prerequisites to obtaining business judgment rule protection set forth in *MFW* were met.

In its March 2014 *MFW* decision (discussed in the Q1 2014 edition of the *Recap*), the Delaware Supreme Court announced that the business judgment rule would apply to controlling stockholder transactions if the transaction is at the outset conditioned upon (i) the approval of a well-functioning and empowered special committee of independent directors and (ii) the informed and uncoerced approval a majority-of-the-minority stockholders. Although *MFW* allows defendants to avoid the stringent standards of entire fairness review when those circumstances are present, Vice Chancellor Laster made clear in his review of the Sprint/Clearwire deal that the absence of any of the requirements laid out in *MFW* will bring the deal back under entire fairness review.

Here, Vice Chancellor Laster determined that the complaint sufficiently alleged that the minority stockholder vote was "not uncoerced." While noting that the deal's widespread support by minority stockholders (including those who were neither subject to lock-up agreements nor receiving benefits from Sprint) was a positive indication of the vote's legitimacy, the Vice Chancellor ultimately decided that three allegations in the complaint undermined the vote. First, the Vice Chancellor noted that the price Sprint paid for the assets may have been low (consistent with the Delaware Supreme Court's observation in *MFW* that well-pleaded allegations of an insufficient price may be enough to bring a controller buyout under entire fairness review). Second, certain minority stockholders who had commercial relationships with Clearwire may not have had interests aligned with other minority stockholders, since they bargained with Sprint to

continue their commercial relationships after the takeover. Finally, a Note Purchase Agreement entered into in connection with this transaction could have significantly diluted the minority stockholders if they rejected the deal. The Vice Chancellor emphasized that the potential coercion created by the Note Purchase Agreement would have been enough on its own to make the deal fail the *MFW* test.

Because the complaint sufficiently alleged that the second prong of *MFW* was not met, the Court applied the entire fairness level of review at the motion to dismiss stage of litigation. The Vice Chancellor emphasized, however, that if, during discovery, the facts show that there was no coercion of the minority stockholder vote, then *MFW* would apply and the defendants would be evaluated under business judgment review at subsequent stages in the proceedings. (*ACP Master, Ltd., et al. v. Sprint Nextel Corporation, et al.*, C.A. No. 8508-VCL (Del. Ch. June 18, 2014)).

Report Shows Continued Ubiquity of Stockholder M&A Litigation

In early March, Cornerstone Research issued its annual report on stockholder M&A litigation. Unsurprisingly, the report concluded that stockholder litigation challenging public company transactions remains pervasive, with lawsuits filed in connection with 94% of transactions announced in 2013 that were valued over $100 million. The report also showed that multi-forum M&A litigation remains common, as 62% of stockholder challenges involved actions filed in multiple jurisdictions. However, the report detailed a substantial decrease in the number of cases filed in three jurisdictions, noting an approximately 50% decrease in such cases over the past three years. That decrease could be attributable to defendants' tactical responses – including the invocation of the PSLRA discovery stay – to what had been a rising trend of stockholder plaintiffs filing parallel M&A actions in federal courts.

The report also concluded that – as practitioners are well aware – over 90% of stockholder M&A suits resolve pre-closing through non-monetary settlements. Indeed, only 2% of settlements reached in 2013 involved a monetary payment, as the vast majority of settlements included only the issuance of supplemental public disclosures and/or a modification of deal terms. Interestingly, the plaintiffs' attorneys' fees associated with such non-monetary settlements declined in 2013, with the average fee requested declining to $1.1 million in 2013 from $1.4 million in 2011 and 2012. And fee awards similarly declined, with plaintiffs receiving an average award of less than $500,000. The Court of Chancery also appears to have been more active in reducing requested plaintiffs' fee awards, awarding less than the requested fees in almost 35% of settlements. (Olga Koumrian, Shareholder Litigation Involving Mergers & Acquisitions, Cornerstone Research Review of 2013 M&A Litigation (Mar. 2014)).

U.S. Supreme Court Upholds Fraud on the Market Securities Class Actions and Largely Preserves the Status Quo

On June 23, 2014 the United States Supreme Court resisted the opportunity to put meaningful curbs on proliferating securities class actions, preserving most of the status quo in such cases.

The Court's much anticipated decision in *Halliburton Co. v. Erica P. John Fund, Inc.* (No. 13-317, 2014 U.S. LEXIS 4305 (U.S. June 23, 2014)) addressed the continued vitality of the "fraud on the market" theory and the conditions that trigger its application. Here, plaintiffs alleged that Halliburton had made misrepresentations regarding, among other things, the anticipated benefits of its merger with another company, in order to inflate its stock price. The "fraud on the market" theory, originally adopted by the Supreme Court in 1988 in *Basic v. Levinson*, permits a plaintiff – and investor classes – to substitute *actual* reliance on a false or misleading statement with a *presumption* of reliance on the "integrity of the market." Under *Basic,* the presumption of reliance is available to plaintiffs and classes who establish that the market for the subject security is "efficient." Over the years, the effect of the twin holdings in *Basic* – adopting the "fraud on the market" presumption of reliance predicated upon "market efficiencies" – coupled with the ease of proving "efficiency," has been to promote virtually automatic certification of investor classes. The enormous exposure certified classes pose, in turn, have induced settlements of securities cases even where the liability risk seems remote.

The *Halliburton* case challenged this regime, asking the Court to extinguish the "fraud on the market" theory altogether or reshape the conditions under which it could be invoked. Among other things, Halliburton argued that the economic theory of "market efficiency" upon which *Basic* was built had been widely discredited.

In a 6-3 decision authored by Chief Justice Roberts, the Court rejected Halliburton's argument that the currently ongoing academic debate about "market efficiency" undermined *Basic*'s reasoning. According to the Court, "Halliburton has not identified the kind of fundamental shift in economic theory that could justify overruling a precedent on the ground that it misunderstood, or has since been overtaken by, economic realities."

The Court also declined to alter a plaintiff's burden to secure certification of investor classes based on the "fraud on the market" theory, specifically a proposal raised at oral argument that would have required plaintiffs to prove that the alleged fraudulent disclosure actually impacted the stock price in order to invoke the presumption.

Although the Court rejected Halliburton's two principal arguments, it did permit defendants to oppose class certification with evidence that an allegedly false statement did not actually have a price impact on a company's stock. The Court held that defendants must be afforded the opportunity at the class certification stage to present evidence to rebut the presumption that the alleged misrepresentation had a "price impact" on the security. According to the Court, although *Basic* entitles plaintiffs to a presumption of a price impact, "it does not require courts to ignore a defendant's direct, more salient evidence" to the contrary. A defendant who can show that an allegedly false statement did *not* impact the market price of a security can use that evidence to oppose class certification. Although that argument could always have been made on the merits, the Court permitted it to be accelerated to the class certification stage.

The *Halliburton* decision adds only a small additional weapon to defendants' already limited arsenal to oppose class certification in securities class actions. And its utility may be slight. The

argument is likely to have most application to circumstances involving large cap issuers where the price impact of allegedly false or misleading statements is difficult to isolate. For large cap companies, what economists label "multiple confounding factors" sometimes preclude a reliable conclusion that a statement had a price impact. For small and mid-cap issuers, those "confounding factors" are less likely to be present.

Tax News

Corporate Expatriations/Inversions Continue to be Considered by U.S. Companies

For the past few months, it has been widely reported that a handful of U.S. corporations are or have thoughts of expatriating in a transaction called an expatriation or inversion.

In an expatriation (or inversion), the corporate structure of a U.S.-based multinational group is altered so that the historic U.S. parent company becomes a subsidiary of a corporation organized in a foreign jurisdiction. Typically, that foreign jurisdiction (*e.g.*, Ireland, the UK and Switzerland) affords a preferential tax regime (a tax system with relatively low effective rates and broad exclusions for income earned by or received from foreign subsidiaries) and a tax treaty with the United States. Critically, a non-U.S. organized parent permits planning to reduce the taxable income of U.S. operations through tax deductible payments to the foreign parent, often consisting of interest or royalties, and by facilitating ownership of non-U.S. assets, including subsidiaries, outside of the U.S. tax net.

In the last two decades, legislative and regulatory changes have restricted the opportunities and increased the costs of corporate expatriations. But a remaining strategy for achieving expatriation is for a U.S. company to combine with a non-U.S. entity, which becomes the parent of the combined group with the non-U.S. entity's historic shareholders continuing to own at least 20 percent of the non-U.S. parent shares.

Inversions under current rules are generally permitted if following the inversion the domestic corporation's historic shareholder base owns less than 80% of the foreign acquiring corporation (the "80% test"). If the 80% test is not met, the foreign acquiring corporation is treated as a domestic corporation for all U.S. tax purposes, absent certain difficult to meet exceptions, including where the foreign parent has substantial assets, employees and local customer revenue in the foreign parent's place of organization (the "substantial business exception"). The current anti-inversion rules also can eliminate certain historic U.S. tax assets where pre-combination owners of the domestic corporation continue to own at least 60% of the post-combination foreign parent company (the "60% test").

Notable Deals

Hillshire/Pinnacle Deal Terminated in Favor of Tyson/Hillshire Deal

The Hillshire Brands Company's previously announced acquisition of Pinnacle Foods Inc. has been terminated in favor of a $63 per share all-cash offer for Hillshire's stock from Tyson Foods, Inc. After receiving Tyson's offer, which was contingent upon termination of the Pinnacle merger agreement, Hillshire's board of directors withdrew its recommendation to shareholders to approve the Pinnacle acquisition. As a result of a "force the vote" provision in the Pinnacle deal, Hillshire's board could not terminate the merger agreement unilaterally even if it believed that another proposal would create more value for Hillshire shareholders, but the board was permitted to recommend against the Pinnacle deal to shareholders, who would then almost certainly vote it down. However, Hillshire's adverse board recommendation did give Pinnacle the right to terminate the merger agreement and (provided it terminated prior to Hillshire's shareholder vote on the merger) to collect a termination fee of $163 million.

On June 30, 2014, Pinnacle exercised its option to terminate the deal, and Hillshire entered into a merger agreement with Tyson the next day. Tyson is required by the terms of the merger agreement to pay the Pinnacle termination fee.

Strategic Bidder and Activist Investor Team Up to Target Allergan

Activist investor Bill Ackman and his $13 billion hedge fund, Pershing Square, have formed an unusual partnership with Canadian pharmaceutical company Valeant Pharmaceuticals International in a joint attempt at a hostile takeover of Allergan Inc., the maker of Botox. The transaction would combine two mid-sized pharmaceutical companies with expertise in skin and eye-care products, and would be the latest step in Valeant's acquisition-based growth strategy.

In connection with their bid, Valeant contributed $76 million towards Pershing Square's $4 billion purchase of a 9.7% stake in Allergan, pursuant to which Pershing Square became Allergan's single largest stockholder. Pershing Square began aggressively purchasing Allergan stock in February and swiftly accumulated a 4.99% stake, which placed them just below the regulatory reporting limits. After Allergan's stock price rose substantially in response to the high-volume purchase, Pershing Square paused its acquisition program to allow Allergan shares to revert to what they believed to be the company's "unaffected stock price" of roughly $116 per share. Pershing Square resumed its acquisitions in late April, crossing the 5% threshold, and then increased its stake to 9.7% over the next 10 days, at which point it made the necessary 13D disclosures regarding its ownership and Valeant's subsequent plan to acquire Allergan. Following that announcement, the value of Pershing Square's $4 billion stake in Allergan increased by nearly $1 billion.

Should a deal be completed, Pershing Square would retain a large stake in the combined company, which would have more than $12 billion in annual revenue. If Allergan is acquired at a

higher price by a competing bidder, Pershing Square has agreed to share with Valeant 15% of its resulting profit from its Allergan purchases. Beyond the obvious financial incentives, this collaboration benefits both Valeant and Pershing Square by acting as a deterrent to a bidding war, with any would-be interloper at a considerable disadvantage because of the large stake that Valeant and Ackman have amassed in Allergan. Moreover, through their agreement with Pershing Square, Valeant has gained a powerful ally with the experience and incentive structure necessary to take on a battle against a reluctant corporate board – a skillset which will prove critical as Allergan's board remains staunchly opposed to the deal.

Proxy Fight & Lawsuit

To date Allergan's board has refused to meet with Valeant and Pershing Square, which recently filed documents with the SEC to begin a proxy fight to replace most of Allergan's board and give shareholders a chance to consider their current offer, which is roughly $173 per share in cash and Valeant stock, as well as a contingent value right potentially worth an additional $25 per share. In conjunction with the proxy fight, Pershing Square seeks to call a meeting of Allergan's stockholders to vote on board replacements later this year. However, Allergan's poison pill is triggered if a person or group acquires 10% or more of its shares, and Pershing Square has publicly stated its concern that its collaboration with other investors to call a special meeting (which requires the support of 25% of shares) could be seen as working together in such a way as to trigger the poison pill, thereby diluting their stakes.

Pershing Square sent a letter to Allergan's counsel seeking confirmation that Allergan would not invoke its poison pill to obstruct their efforts to call a special meeting. Allergan's reply failed to provide a definitive response, so Pershing Square filed suit in the Delaware Court of Chancery seeking a declaratory judgment to clarify the issue. In granting Pershing Square's request for an expedited hearing, Chancellor Bouchard expressed concern that stockholders' ability to exercise their right to call a special meeting could be rendered "functionally meaningless as a practical matter" because of the deterrent effect of the poison pill. Pershing Square and Allergan subsequently reached a settlement, whereby Pershing Square dropped the lawsuit and Allergan confirmed its poison pill would not kick in if and when Pershing Square calls its special meeting to gather support for the takeover and removal of six of Allergan's nine sitting directors.

Regardless of the eventual outcome, this joint bid by a hedge fund and a strategic bidder represents a possible example for how future deals may be structured in an age of increased investor activism. Simultaneously, it also raises serious questions about how and whether activists and corporations should work together, how companies can defend themselves from hostile offers, and also opens up several potential new concerns about conflicts of interest and possible insider trading.

London Update

England and Wales Court of Appeal Upholds UK Competition Commission's Authority to Bar Transaction Between Two Non-UK Corporations

The England and Wales Court of Appeal recently ruled that the UK Competition Commission had the authority to block Akzo Nobel NV's proposed acquisition of the 51% of shares in Metlac Holding S.R.L. that it did not already own. In so doing, the Court held that the Competition Commission had authority to do so because Akzo was a "person carrying on business in the United Kingdom" pursuant to Section 86(1)(c) of the Enterprise Act of 2002 as Akzo exercised strategic and operational control over its UK subsidiaries.

Akzo is a holding company headquartered in the Netherlands. It has over 450 subsidiaries worldwide, including seven in the UK. Metlac is an Italian company that produces metal packaging coatings, including coatings for many well-known global food and beverage brands. Prior to the proposed acquisition, Akzo owned 49% of Metlac through a Dutch subsidiary, and had a call option to acquire the remaining shares of Metlac, which it attempted to exercise in 2012. Akzo, through a variety of subsidiaries, held a substantial share of the UK market for metal packaging coating, although it did not manufacture or sell packaging coating through any of its seven UK subsidiaries. Metlac also held a material share of that market in the UK. Although Akzo informed nine separate competition regulators of the transaction, the Competition Commission was the only antitrust authority to object to the transaction, finding that the transaction might be expected to result in a "substantial lessening of competition" within the United Kingdom for the supply of metal packaging coatings for beer and beverages (a finding that Akzo did not contest in its appeals). The Competition Commission ultimately concluded that the only sufficient remedy for this lessening of competition was to prohibit the transaction.

Akzo unsuccessfully appealed the Competition Commission's ruling to the Competition Appeal Tribunal, and then appealed to the England and Wales Court of Appeal, challenging the Competition Commission's determination that Akzo was a "person carrying on business in the United Kingdom" such that the Commission had authority to bar the transaction. In evaluating that appeal, the Court adopted the Competition Commission's conclusion that Akzo, although based in the Netherlands, had implemented a global corporate control and reporting structure in which all of Akzo's subsidiaries reported up to the parent company and in which the parent company extensively participated in the subsidiaries' operations. This analysis emphasized the practical realities – as opposed to the formal legal distinctions – inherent in the globally integrated operations of a Netherlands-based parent corporation and its UK subsidiaries.

The Court observed that the Enterprise Act permits enforcement orders of the Competition Commission to extend to conduct outside the UK if an entity is "carrying on business" in the UK. The Court went on to conclude that because Akzo exercised "strategic and operational management and control" over its UK subsidiaries, Akzo was "carrying on business" in the UK within the meaning of the Enterprise Act, and that the Competition Commission thus had

authority to block the transaction. However, in upholding the Competition Commission's authority to do so, the Court was careful to state that the inquiry regarding whether a company carries on business in the UK "will be a fact-intensive question" to be analyzed on a case-by-case basis. This is an important case for establishing the Competition Commission's jurisdiction, marking the first time that it has sought an enforcement order against a foreign company in relation to conduct that occurred outside of the United Kingdom. (*Akzo Nobel N.V. v. Competition Commission & ORS* (England & Wales Ct. of Appeal, Apr. 14, 2014)).

Contributors

Partners:
Lee Allison (New York)
lee.allison@ropesgray.com

Jay Freedman (San Francisco)
jason.freedman@ropesgray.com

Richard Gallagher (San Francisco)
richard.gallagher@ropesgray.com

Howard Glazer (San Francisco)
howard.glazer@ropesgray.com

Jane Goldstein (Boston) (co-head of M&A)
jane.goldstein@ropesgray.com

James Lidbury (Hong Kong) (co-head of M&A)
james.lidbury@ropesgray.com

Carl Marcellino (New York)
carl.marcellino@ropesgray.com

Peter Welsh (Boston)
peter.welsh@ropesgray.com

Marko Zatylny (Boston)
marko.zatylny@ropesgray.com

Professional Support Lawyer:
Fay Anthony (London)
fay.anthony@ropesgray.com

Counsel:
Martin Crisp (New York)
martin.crisp@ropesgray.com

Summer Associates:
Emily Burke (New York)
emily.burke@ropesgray.com

Anita Mohandas (Boston)
anita.mohandas@ropesgray.com

Andrew Pomranke (Chicago)
andrew.pomranke@ropesgray.com

Jonathan Williams (Boston)
jonathan.williams@ropesgray.com

Chief of Legal Knowledge Management:
Patrick Diaz (Boston)
patrick.diaz@ropesgray.com

Associates:
Zachary Blume (Boston)
zachary.blume@ropesgray.com

C. Thomas Brown (Boston)
thomas.brown@ropesgray.com

Richard Conklin (Boston)
richard.conklin@ropesgray.com

James Davis (Chicago)
james.davis@ropesgray.com

Tara Fisher (Boston)
tara.fisher@ropesgray.com

Max Klupchak (San Francisco)
max.klupchak@ropesgray.com

Jeffrey Koh (Chicago)
jeffrey.koh@ropesgray.com

Emily Nagle (Chicago)
emily.nagle@ropesgray.com

Lisa Rachlin (Boston)
lisa.rachlin@ropesgray.com

Jaclyn Ruch (New York)
jaclyn.ruch@ropesgray.com

Adam Shane (New York)
adam.shane@ropesgray.com

Michael Shiposh (Boston)
michael.shiposh@ropesgray.com

Justin Voeks (Chicago)
justin.voeks@ropesgray.com

Christian Westra (Boston)
christian.westra@ropesgray.com

IRS Circular 230 disclosure: To ensure compliance with requirements imposed by the Internal Revenue Service, we inform you that any tax advice contained herein was not intended or written to be used, and cannot be used, for the purpose of avoiding tax-related penalties under federal, state or local tax law. Each taxpayer should seek advice based on the taxpayer's particular circumstances from an independent tax advisor.