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NOTES FROM THE M&A TEAM

WELCOME TO THE NEW ROPES RECAP—our quarterly briefing of M&A news, trends and legal developments. We are thrilled to launch this new publication, which includes contributions from more than 30 members of our global team. Each quarter, the Ropes Recap will highlight noteworthy legal decisions, trends and other developments relevant to M&A—both in the US and globally.

The second quarter of 2018 saw interesting decisions from the Delaware Court of Chancery in a variety of areas. Specifically, *Tesla* and *Oracle* provide additional guidance on when a minority stockholder can be considered a "controller" for purposes of fiduciary duty claims made by other stockholders. In *Feuer v. Redstone,* the Chancery Court refused to dismiss a corporate waste claim pertaining to executive compensation—something not seen in more than 30 years. Finally, in *PR Acquisitions v. Midland Funding,* the Chancery Court confirmed that notice requirements in contracts should be strictly enforced. In addition to those cases, new appraisal decisions continued to rely upon the "efficient capital markets" hypothesis, and declined to recut negotiated deals when there has not been any breach of fiduciary duties.

Outside of Delaware, a New York state court issued a noteworthy decision enjoining the proposed merger of Xerox and Fujifilm without analyzing whether the plaintiff had shown irreparable harm, and compelling Xerox to waive its advance notice bylaw to permit certain stockholders to nominate a slate of insurgent directors. In Washington, in *Blue Lion Opportunity Master Fund v. HomeStreet*, the Superior Court of Washington upheld a board's decision to reject a shareholder notice of director nominations due to technical non-compliance with the Company's advance notice bylaws provision, holding that the determination was subject to the deferential business judgement rule. Given that Delaware has not yet weighed in on this aspect of the advance notice bylaws debate, this decision is one of few providing guidance on such provisions. On the federal level, the Ninth Circuit Court of Appeals split from other Circuits in allowing a Section 14(e) tender offer disclosure claim to proceed without a showing of scienter—meaning this is certainly not the last that will be seen of the issue. Finally, there was a district court's ruling allowing AT&T to complete its acquisition of Time Warner.

This quarter, the EU General Data Protection Regulation (or GDPR) also came into effect. Whether you are a lawyer, accountant, consultant, board member or officer of a public or private business (wherever located), these regulations will have an impact on your ongoing business. Our discussion just skims the surface, as there will certainly be continued developments with respect to this regulation, the market's response, and development of best practices to maintain compliance. In addition, the SEC issued new C&DIs relating to non-GAAP financial measures used in business combination transactions, as well as new interpretations relating to the proxy rules and related disclosure.

With over $2.5 trillion in mergers being announced during the first half of the year, 2018 is shaping up to be a banner year for deal-making. As you will see on the back pages, it has been a busy quarter for Ropes & Gray dealmakers. We encourage you to reach out to any member of your Ropes team (or the Ropes Recap team) with any questions regarding the contents of this Ropes Recap or any other M&A legal developments of interest to you. We look forward to continuing to bring you M&A news, trends and legal developments in the future.

Thank you.
Ropes Recap Editors

New York Supreme Court Enjoins Xerox Acquisition

ON APRIL 27, 2018, Judge Ostrager of the Commercial Division of New York Supreme Court (New York's trial level court) enjoined a proposed acquisition by Fujifilm Holdings Corp. of a controlling interest in Xerox Corp., which was to be effected in three steps, through (1) the redemption of Fuji's interest in a joint venture between Fuji and Xerox, followed by (2) the issuance of new common shares of Xerox to Fuji, and (3) the payment of a special dividend to the Xerox stockholders. The Court also compelled Xerox to waive provisions of its advance notice bylaw, enabling activist investors to nominate a competing slate of directors after the otherwise applicable deadline. The Court's decision has been recognized as precedent-setting New York case law and as a victory for activist shareholders (most notably, Carl Icahn, Xerox's largest shareholder, and Darwin Deason, Xerox's third largest shareholder).

The litigation centers on the conflicted role of Xerox CEO Jeff Jacobson and certain of the directors in that transaction. Messrs. Icahn and Deason publicly opposed the transaction, and Mr. Deason and certain Xerox stockholders sought to enjoin the deal. Following expedited discovery, the Court held a preliminary injunction hearing, after which it enjoined the transaction. The Court found that the plaintiffs had shown a likelihood of success on the merits of their claims, and that the transaction should not be evaluated under the deferential business judgment standard of review because Jacobson and certain other Xerox directors were personally interested in the transaction. In particular, the Court noted that Jacobson (who would otherwise have been fired as Xerox's CEO) would become the CEO of the combined company and that certain Xerox directors would have become directors of the combined company. As a result, the Court applied the more rigorous entire fairness standard of review, holding that the transaction failed to meet both the fair dealing and fair price prongs of that test because (i) the director defendants acted in bad faith in structuring a deal that Xerox's own financial advisor had determined undervalued the company; and (ii) Jacobson had, upon learning he would be replaced, "abandoned the board's request to obtain a value-maximizing all-cash transaction and engineered the framework for a one-sided deal that includes Jacobson retaining his position as CEO post-transaction." The Court also determined that the plaintiffs' aiding and abetting claim against Fuji was likely to succeed on the merits. The Court found that plaintiffs established that Fuji's executives believed the acquisition "disproportionately favored Fuji at the expense of Xerox" and that they were well aware of, and benefited from, Jacobson's conflict.

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Interestingly, the Court's decision did not analyze two of the three elements under the controlling New York standard for whether a preliminary injunction should be issued — (i) whether the plaintiff has shown irreparable injury; and (ii) whether the balance of equities weighs in favor of an injunction. Here, the Court focused solely on the plaintiffs' probability of success on the merits and preliminarily enjoined the transaction despite the absence of any competing bidder—an outcome that might not have occurred had this action been litigated in the Delaware courts.

Because the transaction was announced after the deadline for nominating directors to the board had already passed, the plaintiffs petitioned the Court to compel Xerox to waive its advance notice bylaw and permit them to nominate a competing slate of directors. In the Court's analysis of the issue, it adopted the Delaware test articulated in *Hubbard v. Hollywood*, which is the first instance of which we are aware in which a non-Delaware court has adopted that test. The *Hubbard* standard provides that "a shareholder is entitled to a waiver of a corporation's advance

notice deadline for nominating directors when there is a material change in circumstances of the corporation after the nomination deadline." In concluding that the plaintiffs had satisfied that standard, the New York Court held that the board had caused a material change in circumstances to occur after the deadline. The Court therefore compelled Xerox to waive its advance notice bylaw.

Following the Court's decision, Jacobson and most of the other Xerox directors resigned and were replaced by representatives of Messrs. Deason and Icahn. Xerox then terminated the merger agreement with Fuji. In response, Fuji has filed suit in New York federal court seeking payment of the more than $1 billion termination fee provided for in the merger agreement, as well as billions in damages from synergies and other benefits Fuji claims it would have received had the transaction not been improperly terminated. We will continue to monitor the case and provide any relevant updates.

In Re Xerox Corp. Consol. Shareholder Litig., 2018 WL 2054280, 2018 N.Y. Slip Op. 28137 (Sup. Ct. Apr. 27, 2018).

AT&T/Time Warner Vertical Merger Case

ON JUNE 12, 2018, after a six-week trial, a federal district court denied the Department of Justice's request to enjoin AT&T Inc.'s acquisition of Time Warner Inc., finding that the DOJ had not satisfied its burden to show that the transaction would likely lessen competition substantially. This case represents the first litigated decision in which the government has challenged a vertical merger—one that involves firms that do not operate in the same market and produces no immediate change in the level of concentration in any relevant market—in four decades.

In October 2016, AT&T and Time Warner entered into a definitive agreement pursuant to which AT&T would acquire Time Warner in a stock-and-cash transaction valued at $107.50 per share, representing a total transaction value of over $108 billion. Following the announcement of the deal, the DOJ's Antitrust Division conducted an investigation of the proposed merger's legality. On November 20, 2017, the government sought to enjoin the proposed merger under Section 7 of the Clayton Act, which prohibits acquisitions, including mergers, where the effect of such acquisition may be to lessen competition substantially.

In this case, the challenged vertical merger involved the combination of Time Warner's popular video content with AT&T's distribution of video content. The Court's ruling highlighted the difficulties of opposing vertical mergers. According to the Court, for example, vertical mergers can eliminate "double marginalization"—the price-reducing effect of combining firms at two levels in a supply chain. While the government acknowledged that the merger would result in benefits to AT&T subscribers, it contended that the merger would also likely result in a substantial lessening of competition. First, the government argued that the merger would enable Time Warner to charge AT&T's rival distributors—and ultimately consumers—higher prices for its content because of its post-merger relationship with AT&T. Second, the government claimed that the merger would substantially lessen competition by creating an increased risk that the combined firm would act, either unilaterally or in coordination with Comcast-NBCU, to thwart the rise of lower-cost, consumer-friendly virtual multi-channel video program distributors that were allegedly challenging the traditional pay-TV model. Third, the government alleged that the combined firm could harm competition by preventing AT&T's rival distributors from using HBO as a promotional tool to attract and retain customers. The Court analyzed each of these theories of harm to competition in turn and found that the government did not provide sufficient evidence to support any of them.

On June 14, 2018, two days after the Court's ruling, AT&T completed its acquisition of Time Warner. At the time of this writing, the DOJ has filed its notice of appeal, which is pending. The D.C. Circuit agreed to hear the appeal on an expedited basis.

United States v. AT&T Inc., No. 17-2511 (RJL) (D.D.C. June 12, 2018).

Delaware Courts Consider Whether Minority Stockholders Are Controllers

RECENT DECISIONS IN *TESLA* AND *ORACLE* offer new insight into how the Delaware Court of Chancery will evaluate whether, in a conflicted transaction, a minority stockholder is a controller and therefore subject to the elevated "entire fairness" standard of review, which requires demonstration of both a fair price and a fair process.

The *Tesla* litigation arose from Tesla's merger with SolarCity, which was approved by a vote of the shareholders of both companies. Elon Musk owned a 22% equity interest in Tesla and served as its Chairman and CEO while he was also a member of the SolarCity board of directors. In addition, Musk's cousin was the CEO of SolarCity, and Musk also held a 22% stake in SolarCity. Although Tesla and Musk argued that Musk's beneficial ownership of only 22% of Tesla's stock should not cause Musk to be deemed a controller, the Court found that Musk had "outsized influence" over the Tesla board, which made Musk a controller and subjected the transaction to the more rigorous standard of review. Several factors contributed to the Court's finding, including that (1) the Tesla board did not form a special committee to evaluate the transaction, (2) Musk personally selected Tesla's financial and legal advisors for the transaction and (3) Musk is the public face of Tesla and is intimately and indistinguishably linked with the company. The decision also appears to have been influenced by a requirement under Tesla's bylaws that a two-thirds supermajority of stockholders approve important corporate and governance decisions, such as board compensation and mergers and acquisitions. The Court determined that the supermajority requirement made it extremely burdensome to approve any such transaction without Musk's support.

In *Oracle,* stockholders challenged Oracle's acquisition of NetSuite, which was allegedly controlled by Oracle's founder, Larry Ellison. In evaluating the independence of Oracle's directors for purposes of determining whether the stockholder plaintiff was excused from having to demand that the board bring suit in connection with the NetSuite transaction, the Court considered the stockholders' arguments regarding Ellison's alleged influence over the other directors. The Court's analysis focused on the directors who comprised the special committee of the Oracle board formed to consider the potential NetSuite transaction. Although Ellison owns only 28% of Oracle's stock, and although the stockholders' arguments regarding Ellison's influence were somewhat unique, the Court nevertheless concluded that he may have held enough influence over Oracle and the special committee members to render them not independent for purposes of the motion before the Court.

It is important to note that, while the *Tesla* and *Oracle* decisions have implications for the analysis to be conducted when determining whether minority stockholders can be deemed "controllers" of a company, they do not guarantee that Delaware courts will view all allegedly domineering minority stockholders as having a controlling influence. In fact, in *Dell*, the Delaware Supreme Court found that, with respect to Michael Dell's management-led buyout, Michael Dell was not a controller even though he controlled 16% of Dell and was a powerful figurehead at the company. The Court's decision was guided by the fact that Michael Dell took several steps to ensure that the company ran a fair process in which he would not have outsized control, most notably by permitting an independent committee of the board to evaluate the transaction and by consenting to a majority of disinterested stockholders' approval condition. Mr. Dell also agreed to cooperate with other potential buyers (and did engage with competing bidders in the diligence process), which further leveled the transaction playing field.

In certain circumstances, it may be unclear as to whether a Delaware court will find that a minority stockholder's influence is sufficient to render it a controller for purposes of a challenged transaction. In such circumstances, the company and stockholder may consider preemptively taking actions to reduce the likelihood that the stockholder will be found to be a controller, including (alone or in combination): (1) creating a fully empowered and independent board committee (and allowing the committee to hire its own financial and legal advisors); (2) recusing the stockholder (and its board designee(s)) from the board deliberations; (3) requiring the transaction to be approved by a

majority of the unaffiliated stockholders; (4) obtaining a fairness opinion; (5) depending on the nature of the transaction, running a competitive auction process to encourage others to make offers; and (6) if applicable, engaging with other interested parties and allowing them to perform due diligence.

In re Tesla Motors, Inc. Stockholder Litig., C.A. No. 12711-VCS (Del. Ch. Mar. 28, 2018) and *In re Oracle Corp. Derivative Litig.*, C.A. No. 2017-0337-SG (Del. Ch. Mar. 19, 2018).

Chancery Court Allows Straight Path Stockholders to Pursue Direct Claims Against the Company's Former Controlling Stockholder

ON JUNE 25, 2018, the Delaware Court of Chancery denied a motion to dismiss the claims of Straight Path Communications Inc. stockholders against the company's controlling shareholder. The minority stockholders alleged that the controlling stockholder used his position to extract significant personal benefits from the sale of Straight Path to Verizon.

As background, IDT, which is controlled by its former CEO, Howard Jonas, was Straight Path's former parent company. When IDT spun out Straight Path in 2013, it agreed to indemnify Straight Path for liabilities arising from pre-spinoff conduct. Following that spin-off, Straight Path entered into a consent decree with the Federal Communications Commission which, among other things, required Straight Path to pay a $100 million fine. The consent decree also required Straight Path to sell its spectrum licenses and deliver 20% of the proceeds from that sale to the FCC. The actions giving rise to the fines arose prior to the spin-off and were therefore indemnifiable by IDT.

Straight Path formed a special committee in connection with its FCC-mandated sale of spectrum licenses. That committee also considered a sale of the entire company, as well as a potential indemnification claim against IDT. With respect to the indemnification claim, the special committee determined that potential bidders would be hesitant to pursue claims against IDT, so it considered creating a separate litigation trust that could pursue the claims.

In addition to majority voting control over both IDT and Straight Path, Mr. Jonas also had consent rights with respect to any significant transactions that required approval by Straight Path's stockholders, including a merger or a sale of significant assets. Upon learning of the special committee's discussions regarding potentially establishing a litigation trust to pursue the indemnification claim against IDT, Mr. Jonas allegedly contacted each member of the committee and threatened to scuttle the transaction process if the committee pursued that claim or established a litigation trust. Mr. Jonas was also alleged to have personally threatened the committee members and their counsel. At this point, the Straight Path special committee had been able to precipitate a competitive sales process, which resulted in multiple premium offers to acquire the company.

> **Controllers must exercise caution** in transactions where they could reasonably be perceived to have extracted a benefit not otherwise available to minority stockholders.

To avoid jeopardizing the potential transaction, the committee agreed to settle the IDT indemnification claim for $10 million and sell certain Straight Path intellectual property assets to IDT for $6 million—even though the FCC consent decree valued those assets at $50 million and the indemnification claim appears to have been worth far more than $10 million.

In evaluating the defendants' motion to dismiss, the Court of Chancery first determined that the stockholder plaintiffs' claim was direct and not a derivative claim that would have been extinguished by the closing of the transaction. The Court then noted that as a controlling stockholder, Jonas owed a fiduciary duty to the corporation and its minority

stockholders and was prohibited from benefiting himself at the expense of the other stockholders. Based on the facts alleged, the Court determined that the settlement agreement with IDT deprived the company's stockholders of the value of the indemnification claim against IDT, which was potentially worth over half a billion dollars, and may have underpaid in acquiring the Straight Path intellectual property assets. Therefore, the Court found it to be a reasonable inference that Jonas, through IDT, could have breached his fiduciary duties by improperly diverting merger consideration that would have otherwise gone to the stockholders. This case is another example of how controllers must exercise caution in transactions where they could reasonably be perceived to have extracted a benefit not otherwise available to minority stockholders.

Following the Court's decision, at the request of IDT and Jonas, the Court of Chancery certified an interlocutory appeal to the Delaware Supreme Court.

In re Straight Path Commc'ns Inc. Consol. S'holder Litig., C.A. 2017-0486-SG (Del. Ch. June 25, 2018).

Executive Compensation as Possible Corporate Waste

FOR THE FIRST TIME IN DECADES, the Delaware Court of Chancery denied a motion to dismiss involving a corporate waste claim that the approval and payment of executive compensation was a breach of fiduciary duty. In a derivative suit against CBS Corporation, a stockholder alleged that, in 2014, the directors of CBS approved over $13 million in cash compensation to Sumner Redstone (the controlling stockholder, former Executive Chairman, and now Chairman Emeritus of CBS) despite knowing that Redstone, then 91, was incapacitated and could provide no services of any value to the company. It was alleged that the approval of the payments constituted a breach of fiduciary duty as a waste of corporate assets and would result in unjust enrichment to Redstone. This case is one of a myriad of actions winding their way through the courts relating to the control of CBS Corporation, and this decision along with some of the other decisions are likely to provide guidance for boards of corporations with controlling stockholders and/or the controllers themselves.

In his opinion, Chancellor Bouchard noted that "it takes an extreme factual scenario for a plaintiff to state a claim for bad faith or waste" and a plaintiff must therefore show that the corporation entered into a transaction in which it received consideration so inadequate in value that no person of ordinary, sound business judgment would deem it worth what the corporation has paid. The Court stated that such a showing is even more difficult for a plaintiff in the context of employee compensation, where courts "afford great deference to a board's decision."

In pleading its claim of corporate waste, the plaintiff focused on Redstone's employment agreement, which granted him $1.75 million annually for his position as Executive Chairman and expressly required Redstone to be "actively engaged" in (1) the overall leadership and strategic direction of CBS, (2) providing guidance to senior management, (3) the coordination of Board activities, and (4) communication with various constituencies. The plaintiff alleged that CBS continued to pay Redstone for 20 months under that agreement despite allegedly knowing that he was not "actively engaged" in any manner with the company. The plaintiff further alleged that board records supposedly demonstrated that the board never discussed terminating Redstone's employment and salary.

Redstone also received a $1 million salary for his role as Chairman Emeritus for his "continuing availability for advice and consultation and continuing participation on the CBS Board of Directors," and the plaintiff alleged that the board authorized that salary despite knowing that Redstone could neither provide advice nor participate in meetings. Similarly, the plaintiff alleged that the board never discussed whether to terminate this payment obligation.

Chancellor Bouchard found that the plaintiff's allegations—if proven at trial—could establish that Redstone's contributions to CBS "were so negligible and inadequate in value that no person of ordinary, sound business judgment would deem them worth the millions of dollars in salary

that the Company was paying him" and, if proven, could establish that the Board's "extended period of inaction is inexplicable." Chancellor Bouchard therefore ruled that the plaintiff had adequately pled a claim of corporate waste and denied the defendants' motion to dismiss.

While this is the first time in more than thirty years that allegations of compensation as corporate waste have survived a motion to dismiss, the decision focused on the allegations in the complaint, which, if proven, amounted to an "extreme factual scenario." Further, the Court's focus on the absence of any contemporaneous board records discussing Redstone's compensation cautions boards concerning the importance of a fully developed and documented record, particularly on matters that could be subject to scrutiny, criticism or challenge.

Feuer v. Redstone, No. 12575-CB (Del. Ch. Apr. 19, 2018); *CBS Corp. v. Nat'l Amusements, Inc.,* No. 2018-0342-AGB (Del. Ch. May 17, 2018); *Nat'l Amusements, Inc. v. Moonves,* No. 2018-[]-AGB (Del. Ch. May 29, 2018); *Westmoreland Cnty. Emps. Ret. Sys. v. Nat'l Amusements, Inc.,* No. 2018-0392-AGB (Del. Ch. May 31, 2018).

Ninth Circuit Splits from Five Other Circuits; Requires Only a Showing of Negligence for Claims Under Section 14(e) of the Exchange Act

ON APRIL 20, 2018, in *Varjabedian v. Emulex Corp.*, the Ninth Circuit held that plaintiffs asserting claims under Section 14(e) of the Securities Exchange Act of 1934 need only show negligence, rather than scienter. In reversing the district court's decision dismissing the complaint, the Ninth Circuit split from five other circuits, including the Second, Third, Fifth, Sixth, and Eleventh Circuits. Given this split, the *Emulex* decision and the negligence/scienter issue that it raises under Section 14(e) may be ripe for review by the Supreme Court. Absent reversal, the Ninth Circuit's decision could result in an increased number of class action suits involving tender offer disclosure claims under Section 14(e) being filed in federal district courts in the Ninth Circuit. This would follow an increase in Section 14(a) disclosure claims being filed in federal courts across the country following the drastic reduction in disclosure-only settlements in the Delaware Court of Chancery following that Court's decision in *Trulia*.

The Ninth Circuit's decision restored a previously dismissed stockholder plaintiff's claim that Emulex Corporation violated the federal securities laws by issuing a false and misleading Schedule 14D-9 Recommendation Statement in connection with Avago Technologies Wireless (U.S.A.) Manufacturing Inc.'s 2015 tender offer for all of the outstanding shares of Emulex's common stock. The plaintiff asserted that Emulex's Schedule 14D-9 was false and misleading because it omitted a description of a one-page premiums paid analysis that Emulex's financial advisor had prepared for the Emulex Board of Directors. That analysis related to acquisitions of seventeen semiconductor companies between 2010 and 2014, and showed that, while Emulex's 26.4% premium fell within the range of the semiconductor merger premiums for these companies, it was below average. In connection with the deal, Emulex's financial advisor opined that the consideration to be received in the merger was fair, despite this below-average premium, and Emulex elected not to summarize the premiums paid analysis in its Schedule 14D-9. In granting the defendants' motion to dismiss, the district court held that Section 14(e), which regulates the conduct of a broad range of persons with respect to the making or opposing of a tender offer, required a showing of scienter and that the plaintiff failed to meet his burden to show that Emulex and its directors had engaged in intentional wrongdoing in omitting the premiums paid analysis from the Schedule 14D-9.

> **The Ninth Circuit** split from five other circuits, including the Second, Third, Fifth, Sixth, and Eleventh Circuits.

The Ninth Circuit observed that the district court had re-

lied on decisions from five other circuits, all of which had previously held that Section 14(e) disclosure claims require the complaint to plead facts supporting an inference of scienter, or intentional wrongdoing. However, the Ninth Circuit found the rationale underpinning those five circuit courts' decisions unpersuasive. In distinguishing those decisions, the Court noted that they were based on the shared text found in both Rule 10b-5 and Section 14(e). However, based on what it considered to be important distinctions between the two provisions, the Supreme Court's decisions in *Ernst & Ernst v. Hochfelder* and *Aaron v. SEC*, and the legislative history and purpose of the Williams Act, the Court concluded that Section 14(e) requires only a showing of negligence, not scienter.

On the merits of the claim, the Ninth Circuit noted that the district court did not determine whether the omission of a summary of the premiums paid analysis from the Schedule 14D-9 constituted an omission of a material fact in the context of the entire transaction. However, in remanding the case for further consideration by the district court, the Court stated that it will be "difficult to show that this omitted information was indeed material." In this regard, we note that while a premiums paid analysis is included in many financial advisor presentations providing an analysis of the merger consideration, it is generally not considered by financial advisors to be a fundamental valuation analysis for purposes of a fairness opinion. In addition, the Ninth Circuit's comment regarding materiality underscores that defendants will continue to have additional, potential dismissal arguments in Section 14(e) disclosure actions.

Varjabedian v. Emulex Corp., No. 16-55088, 2018 WL 1882905 (9th Cir. Apr. 20, 2018).

Approval of Enhanced Advance Notice Bylaws

ON APRIL 3, 2018, the Superior Court of Washington for King County issued a decision affirming the use of enhanced advance notice bylaws and finding that the board's decision to reject a deficient notice is an exercise of its business judgment. This is an important decision because Delaware courts have not yet addressed the validity of enhanced advance notice bylaws. The decision is also a reminder of the importance of well-drafted advance notice bylaws, which can serve as an effective first line of defense to a hostile proxy contest. Likewise, shareholders seeking to nominate candidates should carefully review the target company's advance notice bylaws to ensure that they satisfy every procedural requirement, no matter how trivial.

Chancery Court Requires Strict Compliance with Notice Provision

The Delaware Court of Chancery recently permitted a seller to recover all of the funds held in an indemnification escrow account because the buyer failed to comply with express notice provisions in the purchase and escrow agreements. Those agreements required the buyer to provide written notice of any indemnification claim to both the seller and the escrow agent, but the buyer provided written notice of certain claims only to the escrow agent (and not to the seller). The escrow agent subsequently informed the seller of those claims prior to the expiration of the indemnification period but the seller sought a court order for release of the escrow funds, claiming that it did not receive sufficient notice prior to such expiration. Although the buyer acknowledged that it had not strictly complied with the relevant notice provisions, it argued that because the seller had actual notice of the claims, there was "substantial compliance" with the notice provisions. The Court rejected that argument, noting that Delaware law followed an objective theory of contracts under which the construction of the contract should be what would be understood by an objective reasonable third party. As the notice provisions in the agreements were clear and the agreements were between sophisticated parties and negotiated at arm's length – the parties were required to strictly comply with the notice provision. The actual notice seller received did not comply with those provisions. This decision is a reminder of the need to meticulously follow the notice requirements of an agreement, particularly when making monetary claims.

PR Acquisitions, LLC v. Midland Funding LLC, C.A. No. 2017-0465-TMR (Del. Ch. Apr. 30, 2018).

HomeStreet's advance notice bylaws require that any notice submission include extensive information regarding the candidate's background and qualifications, including a 52-page questionnaire, as well as any other information required to be disclosed in a proxy statement by incorporating by reference extensive SEC regulations. Blue Lion Capital, a hedge fund, delivered a 133-page notice letter on February 23, 2018—the day before HomeStreet's advance notice deadline. The notice letter informed the board of BLC's intention to nominate two independent directors and submit two substantive corporate governance proposals.

BLC and HomeStreet both subsequently embarked on public "letter campaigns" to defend their positions. On March 1—six days after receiving BLC's notice—the HomeStreet board issued a press release announcing that it had rejected BLC's notice letter as invalid. HomeStreet identified "at least 32 instances of failures to satisfy the requirements set forth in [its] bylaws," including that the notice letter failed to provide information required under the bylaws by reference to the federal proxy rules, such as BLC's estimated proxy fight cost and whether BLC planned to seek reimbursement from HomeStreet. BLC sought to cure the alleged deficiencies in a supplemental submission, which the HomeStreet board rejected as untimely. In response, BLC issued a press release, defending the validity of its 133-page notice letter and denouncing the board's decision as self-interested and in "bad faith." As an example, BLC noted that the HomeStreet board did not reject the notice letter on the grounds that it did not have sufficient knowledge of BLC's intended actions, but rather that the notice letter failed to comply with several procedural technicalities that the board disingenuously read into the bylaws.

BLC also filed a complaint against HomeStreet in Washington state court, seeking a declaratory judgment that its notice letter complied with HomeStreet's bylaw requirements, and moved to enjoin HomeStreet from rejecting the notice letter as invalid. BLC argued that enhanced scrutiny should apply to the board's decision to reject the notice letter and that the bylaw should be struck down because it "unduly restrict[s] the stockholder franchise." The Court held that HomeStreet's advance notice bylaw was valid and that BLC had failed to comply with its requirements. The Court noted that "[a]dvance notice bylaws like the one at issue in this case are common," and that the board's decision to reject the notice letter as invalid should be entitled to deferential business judgement review.

Blue Lion Opportunity Master Fund, L.P. v. HomeStreet, Inc., No. 18-2-06791-0 SEA (Wash. Super. Ct. Apr. 3, 2018) (order denying preliminary injunction).

Delaware Appraisal Decisions

DURING THE SECOND QUARTER OF 2018, the Delaware Supreme Court affirmed, without opinion, the Court of Chancery's decision in *ACP Master*, in which the Court of Chancery had appraised Clearwire's shares at a significant discount to the deal price. Unfortunately, the Delaware Supreme Court's affirmance without discussion or opinion provides dealmakers with little additional clarity on how to assess potential appraisal risk. Also, during the quarter, the Delaware Court of Chancery denied petitioners' motion for reargument in the *Aruba Networks* appraisal litigation. In denying the petitioners' motion for reargument, Vice Chancellor Laster thoroughly defended the reasoning of his earlier post-trial decision, in which he had adopted Aruba's unaffected (pre-announcement) market price as the "best evidence" of Aruba's fair value, and further explained his understanding of the Delaware Supreme Court's decisions in *Dell* and *DFC Global*.

> **The Delaware Supreme Court's** affirmance without discussion or opinion provides dealmakers with little additional clarity on how to assess potential appraisal risk.

ACP Master. On April 23, 2018, the Delaware Supreme Court affirmed, without opinion, the Court of Chancery's decision appraising the shares of Clearwire Corporation at $2.13 per share, which represented a significant discount to the deal price of $5.00 per share.

As previously discussed in a Ropes & Gray client alert (available here), the Court of Chancery found the merger between Sprint Nextel Corporation and Clearwire Corporation to be entirely fair, despite earlier instances of alleged unfair conduct by Sprint (the controlling stockholder) and Softbank Corp. (the proposed acquirer of Sprint), which included alleged obstruction of material business opportunities, vote buying, making retributive threats to Clearwire's minority stockholders, and insisting on dilutive conversion pricing in bridge financing. Nonetheless, the Court of Chancery found that such instances of alleged unfair conduct "made little difference" after Clearwire's stockholders refused Sprint's initial $2.97 per share offer and an interloper, DISH, drove up the deal price in an arm's-length process, leading to an ultimate price of $5.00 per share, which the Court of Chancery found to be fair.

In the related appraisal finding, the Court of Chancery observed that there was no evidence that anyone at Sprint or Softbank believed that Clearwire was worth $5.00 per share on a standalone basis. If the Court of Chancery had relied on the deal price, it would have had to determine the value of synergies anticipated by Sprint and Softbank and back them out from the calculation of fair value. Because none of the parties argued in favor of the deal price, and because the record contained other reliable evidence of fair value, the trial court did not consider the deal price. Instead, in appraising Clearwire's shares at $2.13 per share, the Court of Chancery was persuaded by Sprint's expert's discounted cash flow (DCF) analysis, which had relied on projections prepared by Clearwire's management team in the ordinary course of business.

Aruba Networks. On May 21, 2018, the Delaware Court of Chancery denied a motion for reargument filed by appraisal petitioners, who challenged the Court's prior finding that the fair value of their shares was substantially below the merger price offered in the underlying transaction.

Only Stockholders of a "Constituent Corporation" Are Entitled to Appraisal Rights under the Delaware Appraisal Statute

On June 1, 2018, the Delaware Court of Chancery denied appraisal rights to Dr Pepper stockholders in connection with the acquisition by Dr Pepper Snapple Group, Inc. of Keurig Green Mountain through a reverse triangular merger. The decision eschewed a results-oriented interpretation of Delaware's appraisal statue in favor of a plain reading of the statute's technical requirements, holding that appraisal rights are only available for the shares of a "constituent corporation." That reading limits appraisal rights to stockholders of entities actually being merged or combined with another entity in a merger or consolidation—and not the parent of such entities. Because Dr Pepper was not the constituent corporation in the transaction at issue in the litigation, the Court held that its stockholders were not entitled to appraisal rights under the Delaware appraisal statute.

Under the terms of the merger agreement, Dr Pepper stockholders would receive $103.75 per share in a special cash dividend and would retain their shares of Dr Pepper, which would account for 13% of the equity of the combined company. The indirect owners of Keurig would receive shares of newly-issued Dr Pepper common stock and would hold the remaining 87% of the equity of the combined company.

Certain Dr Pepper stockholders sought appraisal rights in connection with the merger, and asked the Court to elevate the "economic reality" of the transaction over the technical requirements of the appraisal statute. Chancellor Bouchard concluded that it would be "inappropriate" to "disregard the express terms of the appraisal statute to surmise the underlying economic and practical effect" of the transaction and "judicially rewrite the statute to achieve [plaintiffs' desired] result."

City of N. Miami Beach Gen. Emps. Ret. Plan v. Dr Pepper Snapple Grp. Inc., No. 2018-0227-AGB (Del. Ch. June 1, 2018).

The Aruba Networks appraisal litigation arose from Hewlett-Packard's acquisition of Aruba Networks for $24.67 per share in 2016. As previously discussed in a Ropes &

Gray client alert (available here), the Court of Chancery concluded that the best evidence of Aruba's fair value was its 30-day average unaffected market price of $17.13 per share—more than 30% lower than the deal price. The February 2018 post-trial decision was the Court of Chancery's first appraisal ruling following the Delaware Supreme Court's decisions in *Dell* and *DFC Global*, which underscored the Supreme Court's willingness to give significant weight to the deal price as the best measure of fair value where the underlying transaction resulted from a third-party, arm's-length transaction.

In their motion for reargument, the petitioners raised numerous objections to the Court of Chancery's original decision, none of which Vice Chancellor Laster found persuasive. Indeed, the petitioners contended that the Court had fundamentally misapprehended *Dell* and *DFC Global*, and should not have considered Aruba's unaffected market price in determining fair value. The Court rejected that argument, explaining its view that *Dell* and *DFC Global* endorsed the reliability of the unaffected market price as an indicator of fair value, and stating that "trial courts now can (and often should) place heavier reliance on the unaffected market price." The Court also rejected the petitioners' request that they be allowed to submit supplemental evidence regarding whether Aruba's stock traded in an efficient market prior to the transaction, concluding that the evidence presented at trial showed that the Aruba stock possessed the relevant "indicia" of trading in an efficient market.

ACP Master, Ltd. v. Sprint Corp. & ACP Master, Ltd. v. Clearwire Corp., C.A. No. 8508-VCL, C.A. No. 9042-VCL (Del. Apr. 23, 2018); *Verition Pr's Master Fund Ltd. v. Aruba Networks, Inc.*, C.A. No. 11448-VCL (Del. Ch. May 21, 2018).

Importance of Corporate Opportunity Carve-Outs & Related Contractual Provisions

A RECENT DELAWARE COURT OF CHANCERY DECISION highlights the importance for financial sponsors of drafting transaction and governance documents for new investments that expressly disclaim the "corporate opportunity" doctrine and make clear that the sponsor may invest in competitors. The decision arose from a lawsuit filed by Alarm.com, which claimed that its former private equity sponsor, ABS Capital, invested in Alarm's competitor and misappropriated Alarm's trade secrets.

ABS initially had a controlling stake in Alarm, but was diluted and lost its board majority as a result of successive funding rounds and a public offering, though it continued to have one board designee for a period of time. Approximately a year after the last ABS designee left the Alarm board, ABS invested in one of Alarm's direct competitors. ABS's designee on the competitor's board had not served on the Alarm board, and Alarm was not able to plead any facts showing that ABS's former designees on Alarm's board had any direct involvement in ABS's parallel investment.

Shortly after the announcement of ABS's investment in Alarm's competitor, Alarm sued. ABS filed a motion to dismiss, which the Court granted based on its analysis of two primary issues. First, the Court noted that Alarm had not alleged any specific facts showing that anyone affiliated with ABS had actually misappropriated Alarm's confidential information. In so holding, the Court noted that ABS made its investment in Alarm's competitor a year after the last ABS designee left the Alarm board, and that Alarm had not alleged any facts showing that ABS's former designee used Alarm's confidential information improperly.

Second, the Vice Chancellor reviewed the contractual history between ABS and Alarm, including the non-disclosure agreement executed as part of ABS' due diligence in connection with its initial investment in Alarm. The Court also reviewed the successive stockholder agreements executed by the parties, as well as Alarm's corporate charter. The Court concluded that those documents showed the parties' contemporaneous understanding of whether and to what extent ABS could invest in Alarm's competitors, and showed that it was "not reasonably conceivable that the fact of ABS's investment in [the competitor] and the placement of a different ABS representative on the [competitor's board] could support an inference of misappropriation." The Court grounded its conclusion in the express language

of the non-disclosure agreement and stockholder agreements, which allowed ABS to invest in Alarm's competitors, along with the corporate opportunity doctrine carve-out in Alarm's charter.

This decision highlights that financial sponsors should seek to draft transaction and governance documents to make clear that the sponsor may have invested in the target's competitors, may invest in those competitors in the future, and is not subject to the "corporate opportunity" doctrine. While it is not always commercially possible to do so, it is also desirable for such language to also include express "residual information" disclaimers noting that there is information the investor may learn about the target through its investment that it cannot then remove from its collective knowledge, as well as language stating clearly that parallel investments are permissible. Such language could prevent claims for breach of fiduciary duty or misappropriation of trade secrets, or, at a minimum, provide the sponsor with strong arguments to support a motion to dismiss if such claims are asserted.

Alarm.com Holdings, Inc. v. ABS Capital Partners Inc., C.A. No. 2017-0583-JTL (Del. Ch. June 15, 2018).

Court of Chancery Rules that Private Issuance Breached LPA but Rejects Request to Cancel the Securities

ON MAY 17, 2018, the Delaware Court of Chancery held that a private offering by Energy Transfer Equity, L.P. (ETE) was not an impermissible distribution under its limited partnership agreement (LPA), even though the Court also held that the offering was a conflicted transaction that was not fair to the partnership. The case arose following ETE's failed acquisition of The Williams Companies, Inc. In order to reduce its leverage, which it needed to do to consummate the acquisition, ETE conducted a private offering to certain unitholders, including company insiders. Some of the non-participating unitholders challenged the issuance, arguing that it was an impermissible distribution under ETE's LPA and a conflicted transaction that was unfair to the partnership.

After reviewing the LPA, the Court ruled that the private offering was not a "distribution" under the terms of the LPA because it was an issuance for value (as opposed to a distribution that must be made pro rata). However, the Court also determined that the private offering was not fair and reasonable to the partnership. Although ETE's LPA contained various safe harbor provisions for determining whether transactions were fair and reasonable, the Court concluded that none of the safe harbor provisions applied due, in part, to the flawed nature of the conflicts committee that ETE used to approve of the offering. After finding that none of the safe harbor provisions applied, the Court found that the entire fairness standard of review governed the transaction. Applying that standard, the Court decided that the offering provided an additional accrual term to the participants (which is triggered only if distributions under the LPA were reduced). However, although the Court concluded that the offering was unfair, it held that the equity securities should not be canceled because the subscribers never benefited from the provision, as distributions under the LPA were never reduced. Therefore, although there was a breach, no award was appropriate because the plaintiffs did not show that the breach caused any damages to the non-participating unitholders.

In Re Energy Transfer Equity, L.P. Unitholder Litig., C.A. No. 12197-VCG (Del. Ch. May 17, 2018)

The Use of a "Ticking Fee" in the Novartis-AveXis Transaction

ON APRIL 6, 2018, Novartis AG entered into a definitive agreement to acquire AveXis, Inc., a U.S.-based, clinical stage gene therapy company, for approximately $8.7 billion pursuant to a two-step tender offer transaction. Notably, the Novartis-AveXis merger agreement contained a variation of a "ticking fee" provision in the event that Novartis elected to extend the closing date of the transaction in order to obtain regulatory approvals.

A more "classic" ticking fee provision would typically provide for an increase in the per-share cash consideration payable to stockholders as the time period between signing and closing passes certain milestones. However, Novartis and AveXis agreed to a ticking fee provision with two structural components: if Novartis exercised its extension right, and (1) the transaction closed, the $218 per share consideration increased automatically by $7 per share; or (2) the transaction did not close, Novartis's reverse termination fee (initially set at $437 million) would increase by various increments ($105 million, $195 million, and $285 million), depending on how long after July 6, 2018 (the initial closing date) the merger agreement was terminated due to the inability to obtain regulatory approvals. Because Novartis successfully completed its acquisition of AveXis in May 2018, Novartis did not have to pay for any regulatory delay under the ticking fee provision.

Effect of the New GDPR Regulations on M&A Transactions

Starting on May 25, 2018, European regulators are now able to enforce the EU General Data Protection Regulation (GDPR), which provides guidelines for the collection and processing of personal information of individuals within the European Union. The regulations apply to any EU entity, any non-EU entity that offers goods or services to individuals in the EU, or any entity that monitors the behavior of individuals in the EU (including employees, customers, and suppliers). The penalties for non-compliance are quite significant – up to €20 million or, in the case of a controlled group of entities (which, may in certain circumstances, include a private equity sponsor), up to 4% of global revenue of the entire controlled group of entities, whichever is greater. Because of the wide-ranging reach of the regulations, many U.S. companies will need to make sure that they comply with the GDPR, and this may affect U.S. M&A activity in a number of ways.

As an initial matter, a buyer will need to determine whether the target is subject to GDPR and whether the transaction involves a transfer of data covered by the regulations. Buyers will also want to perform diligence on the target's compliance with GDPR because of the significant penalties for non-compliance. In addition, when negotiating acquisition agreements, buyers may want to consider including specific representations and warranties and/or indemnities for GDPR compliance. Finally, buyers may also have post-closing obligations to provide notices to affected individuals.

SEC Supplements Guidance on Non-GAAP Financial Measures in Business Combination Transactions

ON APRIL 4, 2018, the staff of the Division of Corporation Finance (the "Staff") of the U.S. Securities and Exchange Commission supplemented its guidance on non-GAAP financial measures disclosed in connection with business combination transactions by publishing two new Compliance and Disclosure Interpretations ("C&DIs"), which confirmed that, under certain circumstances, financial forecasts provided to a board of directors or to bidders in a business combination transaction are not considered non-GAAP financial measures and, therefore, are not subject to Item 10(e) of Regulation S-K or Regulation G. These SEC rules impose certain restrictions regarding the use of non-GAAP financial measures in SEC filings and public disclosures and require, among other things, the presentation of a reconciliation of the non-GAAP financial measure to the most directly comparable GAAP financial measure.

> **This guidance** should serve to confirm the existing practice to omit GAAP reconciliations for "non-GAAP" financial measures included in financial projections that are disclosed in M&A transactions, as well as potentially limit the ability of the plaintiff's bar to assert federal securities claims based on the omission of such GAAP reconciliations.

The Staff previously issued guidance in October 2017 describing the circumstances pursuant to which financial forecasts included in registration statements, proxy statements or tender offer statements relating to a business combination are not subject to Item 10(e) of Regulation S-K or Regulation G. Specifically, C&DI Question 101.01 stated that financial measures included in forecasts ***provided to a financial advisor*** are not non-GAAP financial measures, if and to the extent: (1) the financial measures are included in forecasts provided to the financial advisor for the purpose of rendering an opinion that is materially related to the business combination, and (2) the forecasts are being disclosed in order to comply with Item 1015 of Regulation M-A or requirements under state or foreign law, including case law, regarding disclosure of the financial advisor's analyses or substantive work. When this guidance was issued, some practitioners questioned whether the Staff's position also applied in cases where the same forecasts were also provided to others, such as the company's board of directors or bidders.

Under the new guidance, the Staff confirmed that:

- a company can rely on the response to C&DI Question 101.01, as discussed above, if the same forecasts provided to a financial advisor are also provided to its board of directors or board committee (C&DI Question 101.02).
- if a company determines that the forecasts it provided to potential bidders in a business combination transaction are material and that disclosure of such forecasts is required to comply with the anti-fraud and other liability provisions of the federal securities laws, the financial measures included in such forecasts would be excluded from the definition of non-GAAP financial measures and therefore not subject to Item 10(e) of Regulation S-K or Regulation G (C&DI Question 101.03).

This guidance should serve to confirm the existing practice to omit GAAP reconciliations for "non-GAAP" financial measures included in financial projections that are disclosed in M&A transactions, as well as potentially limit the ability of the plaintiff's bar to assert federal securities claims based on the omission of such GAAP reconciliations.

SEC Releases New C&DIs on Proxy Rules and Schedules 14A and 14C

ON MAY 11, 2018, the Staff released forty-five new and revised C&DIs regarding its interpretations of the proxy rules and Schedules 14A and 14C, which replace and consolidate the Staff's previously-published telephone interpretations on the same subject. While many of these C&DIs contain non-substantive changes from the corresponding telephone interpretations, four C&DIs include technical revisions and six C&DIs include substantive changes to the prior telephone interpretations. The six C&DIs that include substantive changes related to the following topics:

- cumulative voting (C&DI Question 124.01);
- non-Rule 14a-8 matters (C&DI Question 124.07);
- corporate name changes (C&DI Question 126.02);
- the authorization of additional common stock not involving an acquisition (C&DI Question 151.01);
- the New Plan Benefits Table (C&DI Question 161.03); and
- the elimination of preemptive rights (C&DI Question 163.01).

The Staff has also noted that it is in the process of updating other previously-published telephone interpretations relating to the proxy rules.

SEC Amends Smaller Reporting Company Definition

ON JUNE 28, 2018, the SEC voted unanimously to amend the definition of "smaller reporting company" ("SRC") in the SEC's rules to expand the number of smaller companies eligible to comply with certain scaled disclosure accommodations. The final rules approved by the SEC, which become effective on September 10, 2018, also included amendments to the financial statement requirements of acquired businesses. Currently, Rule 3-05 of Regulation S-X generally requires SEC reporting companies that are acquiring a business to provide separate audited annual and unaudited interim pre-acquisition financial statements of that business if it is significant to the SEC reporting company, based on various investment, asset, and income tests. Previously, when at least one Rule 3-05 test was exceeded at the 50 percent level, the SEC reporting company was required to report a third year of financial statements unless net revenues of the acquired business were less than $50 million in its most recent fiscal year, a threshold that was based on the revenue threshold in the previous SRC definition. Under the final rules, the SEC increased the net revenue threshold in Rule 3-05(b)(2)(iv) of Regulation S-X from $50 million to $100 million, which is consistent with the increase made to the revenue threshold in the revised SRC definition. As a result, companies may omit financial statements of businesses acquired or to be acquired for the earliest of the three fiscal years otherwise required by Rule 3-05 of Regulation S-X if the net revenues of that business are less than $100 million.

Proposed UK Corporate Governance Reforms

CORPORATE GOVERNANCE REFORMS remain high on the UK government's agenda for 2018 and 2019. Following various consultation processes, the government announced a suite of governance reforms in the latter part of 2017. Whilst the majority of these reforms will focus on UK-listed public companies, a number of significant reforms have also been designed to apply to larger UK private companies. To this end, the government has concluded that a focus on corporate governance regimes and stakeholder engagement will apply to all larger UK companies (whether public or private) that satisfy certain threshold criteria (which emphasize the number of employees and economic footprint of the company).

The proposed new measures will be introduced as part of the annual reporting requirements of eligible large companies, and (subject to UK parliamentary approval of the proposed secondary legislation that will implement the regime) will come into effect for ***financial years that commence on or after January 1, 2019.*** UK companies subject to the new regime should start to plan to make appropriate changes to their narrative reporting obligations. U.S. parent companies or other non-UK parent groups that have companies incorporated in the UK within their groups will need to be aware of these new reforms.

The New Measures

(a) **STAKEHOLDER ENGAGEMENT** One of the main areas of reform is driven by the continuing debate around adequacy of stakeholder engagement. Under the proposed reforms, as part of their annual reporting requirements, large companies will now be required to demonstrate how their directors have considered the interests of the company's stakeholders (including employees, suppliers, and customers) when discharging their statutory duty to promote the success of their company. This is an evolution of the existing statutory directors' duty and codifies and increases accountability as regards the basis on which the directors have considered the impact of their decisions on a broader community of stakeholders, beyond the shareholders of the company. The scope and extent of these stakeholder engagement narrative reporting obligations for large private companies will depend on their specific size.

UK companies subject to the new regime should start to plan to make appropriate changes to their narrative reporting obligations.

IMPLEMENTATION OF REFORMS: The new narrative reporting obligations will vary according both to the size of the company and to its existing narrative reporting obligations:

(i) **SECTION 172 STATEMENT** Companies that are required to prepare a strategic report as part their annual reporting obligations (which, in practice, means companies that qualify as large companies for the purposes of their accounting obligations) will now need to include a separate statement describing how the companies' directors have addressed the matters set out in section 172(1)(a) to (f) of the Companies Act 2006, when performing their duty under section 172 to promote the success of the company. Unquoted companies will need to publish this statement on their website. Quoted companies are already required to publish their annual report and accounts on their website;

(ii) **EMPLOYEE ENGAGEMENT STATEMENT** All companies that have, on average, more than 250 employees in the UK will need to include a statement in their directors' report describing the company's actions taken during the financial year to introduce,

maintain or develop employee engagement arrangements and to summarize how the directors have in fact engaged with employees and had regard to their interests, as well as the effect of doing so on the company's principal decisions taken during the financial year.

(iii) WIDER ENGAGEMENT STATEMENT Large companies (namely, companies that qualify as large companies for the purposes of their accounting obligations) will need to include a statement in their directors' report to summarize how the directors have had regard to the need to foster the company's business relationships with suppliers, customers and other stakeholders, and the effect of doing so, including on principal decisions taken by the company during the financial year in question.

(b) REPORTING ON CORPORATE GOVERNANCE ARRANGEMENTS
As part of the reforms, large companies will now be required to disclose details in their directors' report of the corporate governance framework and arrangements that have been in place during the financial year. To this end, they will need to confirm whether they have adhered to a formal corporate governance code; and, if they have, they will need to provide details of the relevant code. The requirement will apply to all companies (whether public or private) that satisfy the requisite threshold criteria: namely, all companies that meet either or both of the following requirements: (i) the company has more than 2000 employees; and (ii) the company has a turnover of more than £200 million, and a balance sheet total of more than £2 billion. If a company has not adopted a corporate governance code during the relevant financial year, the statement of corporate governance arrangements will need to explain the reasons for that omission, and will need to establish what arrangements for corporate governance have applied in their stead. Unquoted companies will need to publish this statement on their website. Quoted companies are already required to publish their annual report and accounts on their website.

Large private companies that come within scope of the new reporting regime have a number of options that they may consider for the purposes of selecting an appropriate corporate governance code. To support companies in this new development, the Financial Reporting Council has worked with a coalition of interested parties to develop the Wates Principles for Large Private Companies which have been devised specifically for the purpose of this new regime (and which are in draft form, subject to a consultation process).

The Merger of Chinese Antitrust Agencies

ON MARCH 21, 2018, China officially started consolidating its three antitrust regulation and enforcement departments into one agency called the State Administration for Market Regulation ("SAMR"). The consolidation of these three antitrust authorities is the most significant change in China's antitrust legal regime since the Anti-Monopoly Law ("AML") came into force in 2008.

Before the creation of SAMR, China had three separate antitrust enforcement agencies:

1. **THE ANTI-MONOPOLY BUREAU** of the Ministry of Commerce ("MOFCOM"), which was primarily responsible for controlling mergers, conducting anti-monopoly examinations on acts of concentration by business operators, and carrying out the negotiation of international competition policies.

2. **THE PRICE SUPERVISION AND ANTI-MONOPOLY BUREAU** of the National Development and Reform Commission ("NDRC"), which was primarily responsible for investigations and enforcement in instances of monopolistic pricing behavior, including the abuse of power by government entities for the purpose of excluding or limiting competition.

3. **THE ANTI-MONOPOLY AND ANTI-UNFAIR COMPETITION BUREAU** of the State Administration for Industry and Commerce ("SAIC"), which was responsible for investigating market dominance behavior, monopoly agreements, and unsanctioned government supported monopolies not related to pricing violations of the AML.

The separation of responsibilities among MOFCOM, NDRC and SAIC led to inefficient (and sometimes inconsistent) enforcement of the AML as the coordination and cooperation among MOFCOM, NDRC and SAIC did not work very well due to the separation of their responsibilities.

Although the consolidation has begun, MOFCOM, NDRC and SAIC continue to handle their existing antitrust cases separately, as the process of consolidating the three authorities into SAMR is still in progress.

In the near future, the consolidation may adversely effect SAMR's ability to accept and review antitrust cases, as the completion of the consolidation may take longer than expected. Some have speculated that the SAMR's failure to approve the Qualcomm-NXP merger, which resulted in the termination of the transaction, may be related to the ongoing U.S.-China trade dispute, but the consolidation of China's antitrust regulatory bodies could have also been a factor.

> **In the near future,** the consolidation may adversely effect the State Administration for Market Regulation's ability to accept and review antitrust cases, as the completion of the consolidation may take longer than expected.

In the long run, the creation of a single antitrust authority may increase transparency, consistency and efficiency for China's antitrust regulation and enforcement. However, it currently remains unclear how SAMR will investigate and enforce cases, as it has yet to develop its own consistent rules and understandings of AML, and the mandate to review and investigate both merger activity and all other sorts of antitrust concerns could result in increased antitrust scrutiny compared to the prior balkanized antitrust enforcement regime in China.

China Unveils Shortened Negative List for Foreign Investment

ON JUNE 28, 2018, the NDRC released a new negative list for foreign investment in China that took effect on July 28, 2018. The length of the list has been reduced from 63 items in 2017 to 48 items this year. This revision of the negative list not only canceled the restrictions on foreign investment in the manufacturing sectors, including automobiles, airplanes, and ships, but also further opened up the fields of finance, transportation, and the service industries to foreign investment.

The 2018 iteration also provides a clearer roadmap and schedule for opening up the automotive and financial sectors as compared to the previous versions of the negative list.

1. **IN THE AUTOMOTIVE SECTOR,** the limitations on foreign-invested shares in companies engaged in the manufacturing of special and new energy vehicles will be eliminated in 2018. The limitations on foreign investment in manufacturers of commercial vehicles will be lifted in 2020 and passenger vehicles in 2022.

2. **IN THE FINANCIAL SECTOR,** shares of Chinese banks held by a single foreign investor or by several foreign investors in the aggregate could not exceed 20% and 25%, respectively, under the prior limitations. These restrictions will be lifted in 2018. In addition, the requirement that a securities company or a securities fund management company must be controlled by a Chinese party will also be abolished in 2018 and foreign investors will be permitted to hold up to 51% of such company's shares This 51% limitation will be removed completely in 2021.

Although the changes to the 2018 negative list for foreign investment appear encouraging on paper, there are doubts about the extent to which this updated list will actually provide greater access to foreign investors. The new sectors to which foreign investors will have access are also sectors dominated by local players, and fair competition remains a key concern as the Chinese government has been criticized for offering support to state-owned enterprises. Other important sectors, including media production, distribution, and broadcasting, will remain on the negative list. The only areas where foreign investors will be permitted within the media industry are cinema construction and operation. However, even these investments still need to be joint ventures with Chinese shareholders, and a Chinese party must control the majority stake.

Although denied by Chinese officials, the adoption of the 2018 negative list is regarded as one of the several steps the Chinese government has recently taken in response to the pressure from the U.S. government to remove all barriers to foreign investment in China.

THE ROPES RECAP

SIGNIFICANT **TRANSACTIONS**

Representing in acquisition of Minute Key, Inc.

Represented in acquisition of Wilson Therapeutics

Representing Advent International in acquisition of 80% stake in Walmart Brazil

Represented in acquisition of Hillgate Travel Limited

Representing in acquisition of Tel NEXX Inc.

Represented in acquisition of B&B Tritech, Inc.

BY THE NUMBERS

ROPES & GRAY ACQUISITION TRANSACTIONS—Q2 2018

80+ Deals

$32+ Billion in Acquisition Transactions

15 Cross-border Deals

10 Countries

30 Industries

Represented in sale of controlling interest to Gemspring and Schroders

Represented in sale of majority interest to KKR

Represented in acquisitions of Inspired Review, LLC and Envision Discovery, LLC

Represented in acquisition of Nizoral

Represented Ares Management in sale of Cordium to ACA Compliance Group

Represented Long Point Capital in sale of CHA Consulting to First Reserve

Representing Intermediate Capital Group in joint partnership investment with HG Saturn Fund into IRIS

Representing Deutsche Bank as financial advisor to Cohu, Inc. in acquisition of Xcerra Corporation

Represented Avenue Capital Group in sale of Hawthorn Leisure Holdings Limited to NewRiver REIT plc

Represented Houlihan Lokey as financial advisor to C.H. Guenther & Son, Inc. in acquisition by PPC Partners

THE ROPES RECAP

SIGNIFICANT **TRANSACTIONS**

Representing in bid to acquire Connecticut Water Services Inc.

Representing PAI Partners and Baring Private Equity Asia in acquisition of WFCI

Represented Partners Group and Charlesbank Capital Partners in acquisition of Hearthside Food Solutions

Represented Silver Lake Partners in acquisition of Environmental Data Resources

Representing in acquisition of investment portfolio of Triangle Capital Corporation

Represented parent company in combination of operations with Skyline Corporation

Represented in acquisition of The Macaluso Group

BY THE NUMBERS

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Represented in acquisition of DW Reporting

Representing TPG Growth in sale of NorthStar Anesthesia to Cranemere

Represented Audax Private Equity and Senneca Holdings, Inc. in sale of Senneca to Kohlberg & Company, L.L.C.

Represented Summit Partners in sale of ABILITY Network to Inovalon

Represented Aquiline Capital Partners in acquisition of RIA in a Box

Represented Bain Capital in acquisition of Toshiba Corp. semiconductor business

Represented in internal restructuring and Series A investment by Mooc-CN Education and Legend Capital

Represented Houlihan Lokey as financial advisor to The Finish Line in acquisition by JD Sports Fashion plc

THE ROPES RECAP

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