ROPES & GRAY

MERGERS & ACQUISITIONS LAW NEWS

THE ROPES RECAP

Q3 2018

In THIS ISSUE

WELCOME TO THE ROPES RECAP OF THE THIRD QUARTER OF 2018

WHILE ACTIVITY REMAINED STRONG, particularly during the end of the quarter, little noteworthy case law came out during the third quarter of 2018. Then, the day after the quarter ended, the Delaware Chancery Court released *Akorn v. Fresenius*, and got the entire M&A world talking. As the dust settles, it doesn't seem as if *Akorn* will be most debated because of its facts (most view it as a bespoke holding, as evidenced by the 246 pages it took VC Laster to walk us through it), but rather because it has made every M&A lawyer change one of their most tried and true statements about M&A agreements—notably, that the Delaware courts had never before found a "Material Adverse Effect." Well, assuming the decision survives appeal, they now have.

Beyond *Akorn*, we did see a couple of key decisions from the Chancery Court. The court rejected a preliminary injunction to block a stockholder vote on the proposed $7 billion merger of drywall producer USG Corp with Gebr. Knauf AG. In a bench ruling, the Court decided that the hostile-takeover protections in DGCL Section 203 did not apply simply because USG's largest stockholder had discussed possible per-share deal terms with the proposed buyer, as the two never had a meeting of the minds on the point. In addition, in *Olenik v. Lodzinski*, the court provided further support for its holding in *Kahn v. M&F Worldwide Corp.*, as it upheld the structure of the transaction in question, which, among other things, included a majority of the minority vote so that the controlling private equity firm who stood on both sides of the transaction could not force its will on minority stockholders. As such, the court applied the business judgment rule, noting its preference in such situations to not second-guess the decisions of corporate fiduciaries, absent a finding of corporate waste. The court also clarified the *ab initio* requirement from the *MFW* decision. Finally, the court continued the line of cases providing that minority stockholders could be considered controllers with its decision in *Basho Technologies Holdco B, LLC v. Georgetown Basho Investors, LLC*. In that matter, the court found that a minority stockholder had used the contractual consent rights granted to it as a preferred stock investor, together with "hardball" negotiating tactics, to force Basho to the brink of insolvency, which left it with no choice but to accept oppressive financing terms from that stockholder.

The Chancery Court also decided a handful of new appraisal cases during the quarter. In two, *Blueblade Capital Opportunities, LLC v. Norcraft Companies, Inc.* and *Solera Holdings*, the court rejected the deal price as a measure of fair value based on the respective pre-transaction processes and deal terms. Both cases showed the court's willingness to get into the weeds on these matters, particularly if it believes the negotiation among the parties has been limited by process, terms or otherwise.

The Delaware Supreme Court provided further guidance on how to apply the *Corwin* standard to M&A transactions—notably, that disclosures to stockholders must faithfully reflect all material facts in order for the parties to benefit from the application of the more director-favorable business judgment rule. In *Morrison v. Berry*, the Supreme

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Court reversed a dismissal by the Chancery Court, providing a cautionary reminder that "partial and elliptical disclosures" can leave stockholders less than fully informed in a transaction, and if so, a board can lose the benefits of the business judgment rule.

Outside of the courts, we did see some noteworthy new law relating to M&A and corporate goverance. The third quarter of 2018 saw California adopt a minimum quota for women on boards of directors of public companies headquartered in the state. The California law is like no other in the nation, as it requires companies with at least five board members to have at least two female board members by 2021 (and more, in the case of larger boards). Whether the law will withstand constitutional challenges and whether or not other states will follow suit remains to be seen.

We also saw enactment of landmark CFIUS legislation. With the Foreign Investment Risk Review Modernization Act, the Committee on Foreign Investment in the United States has been empowered with an added level of scrutiny and influence in M&A transactions involving foreign investments in U.S. businesses. The new law expands the scope of transactions potentially subject to CFIUS review, provides CFIUS the ability to suspend transactions mid-review and, for the first time, requires mandatory filing for certain transactions. Not to be outdone by the U.S., the UK government also published details of its proposed new regime for the scrutiny of foreign investment that may have national security implications. Those proposals are contained in the National Security and Investment White Paper, and a draft Statutory Statement of Policy Intent, which expand on recent reforms that gave the U.K. government greater powers to screen mergers on national security grounds, where the target is involved in the production of military or dual-use technologies or certain other types of advanced technologies.

Finally, in deal practice, we note that the "MeToo" movement has started to impact purchase agreements—buyers are not just focused on diligence for such issues, but have begun to request specific representations and warranties to provide more adequate disclosure around sexual harassment claims or similar matters raised against or by company employees.

Overall, the third quarter of 2018 (and the day after) brought interesting developments across the M&A world. That, plus a heavy flow of continued deal activity (some of which we note on the final pages of this report), made for another active quarter. As always, 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 that interest you. We look forward to continuing to bring you M&A news, trends and legal developments in the future.

Thank you.
Ropes Recap Editors

Delaware Supreme Court Cautions that "Partial and Elliptical Disclosures" Cannot Support the Application of *Corwin* Business Judgment Review

ON JULY 9, 2018, the Delaware Supreme Court held in *Morrison v. Berry* that *Corwin* business judgment review will not apply to stockholder-approved transactions when "partial and elliptical" disclosures leave stockholders less than fully informed. This decision, which reversed a dismissal by the Court of Chancery, serves as a court-described "cautionary reminder" that disclosures to stockholders must faithfully reflect material facts in order for transaction parties to benefit from the director-friendly standard established by the Delaware Supreme Court in *Corwin*.

In the underlying transaction, an affiliate of Apollo Global Management acquired The Fresh Market for $28.50 per share. Apollo had historically expressed interest in acquiring the company, and had engaged in preliminary discussions with its founder and Chairman, Ray Berry, concerning a potential transaction. Following Apollo's unsolicited indication of interest, the company's board formed a strategic transaction committee to review and negotiate a potential transaction, and Mr. Berry agreed to recuse himself from all board meetings concerning a potential transaction. The committee ran a competitive auction process that resulted in multiple premium bids. Following the auction, Fresh Market entered into a merger agreement with Apollo providing for a two-step transaction at a price that represented a 53% premium over the company's unaffected stock price. Mr. Berry and his son, Brett Berry, agreed to roll their equity into the post-closing entity. Holders of a majority of the company's shares held by unaffiliated stockholders tendered their shares in favor of the transaction.

The *Morrison* plaintiffs, whose class action breach of fiduciary duty claim against the company's directors was the subject of this appeal, first pursued the company's books and records through an action under Section 220 of the Delaware General Corporation Law (the "DGCL"). To resolve the Section 220 litigation that was filed, the company produced over 2,000 pages of documents, including board meeting minutes and certain board-level communications, including an email from the Berrys' counsel to the company's counsel, which plaintiffs cited extensively in their complaint.

In their post-closing breach of fiduciary duty action, plaintiffs in *Morrison* claimed that the Berrys had manipulated the transaction process to favor Apollo, thereby causing the transaction to be consummated at an unfair price, and asserted that the Schedule 14D-9 was materially misleading, particularly with respect to the disclosures concerning the relationship between the Berrys and Apollo. The directors moved to dismiss, arguing that, under *Corwin*, the approval (via tender) of the transaction by a majority of fully informed and uncoerced stockholders required dismissal. Vice Chancellor Glasscock agreed, finding that none of the omitted or allegedly misleading information would have been material to stockholders because it would not have made stockholders less likely to tender their shares.

> "**The court cautioned** directors and the attorneys who advise them to avoid 'partial and elliptical disclosures.'"

On appeal to the Supreme Court, relying primarily on the board minutes and the email from the Berrys' counsel to company counsel obtained in the Section 220 proceeding, the plaintiffs argued that the Schedule 14D-9 was materially incomplete or misleading. Reversing the Court of Chancery, the Supreme Court rejected the materiality standard applied by the Court of Chancery, concluding that information is material "if there is a substantial likelihood that a reasonable stockholder would have considered the omitted information important when deciding whether to tender her shares or seek appraisal," which is the customary materiality standard articulated in *TSC v.*

Northway and typically applied by Delaware courts. The Supreme Court also highlighted the duty to avoid misleading partial disclosures.

The Supreme Court then analyzed each of the alleged omissions or misleading statements. The Court concluded that the documents produced in response to the plaintiffs' books and records demand showed "troubling facts regarding director behavior" that were not disclosed in the Schedule 14D-9, and that those facts were material because "they would have shed light on the depth of the Berrys' commitment to Apollo, the extent of Ray Berry's and Apollo's pressure on the board, and the degree that this influence may have impacted the structure of [the] sale process." In particular, the Court was troubled by the allegation that Ray Berry, according to his counsel's email, appeared to have agreed to partner with Apollo early in the process but denied the existence of such an agreement when questioned by the board. As a result, the Court concluded that the company's stockholders were not fully informed when they approved the transaction, and that the *Corwin* business judgment standard of review did not apply.

The Court in *Morrison* emphasized "careful" application of *Corwin* given its potentially case-dispositive impact, and closely scrutinized the company's contemporaneous documents to see if they supported the facts disclosed in the Schedule 14D-9. Given the discrepancies it found, the Court cautioned "directors and the attorneys who advise them" to avoid "partial and elliptical disclosures." This warning underscores the self-evident importance of properly reflecting the underlying factual record in disclosures to stockholders. In addition, the Court also noted certain inconsistencies between the "background of the merger/offer" section in the Schedule 14D-9 issued by the company and in Apollo's Schedule TO, which highlights the need to synchronize target and buyer disclosures, where possible.

More broadly, the decision in *Morrison* illustrates the rising use of Section 220 books and records demands by stockholder plaintiffs in the M&A context. Such demands are being used as a substitute for the pre-closing discovery that plaintiffs previously sought to obtain in connection with expedited proceedings, and, as illustrated in *Morrison*, can be used to attempt to avoid dismissal if the documents produced reveal discrepancies between the factual record and the relevant disclosures.

Morrison v. Berry, et al., C.A. No. 12808-VCG, (Del. July 9, 2018) (revised July 27, 2018).

Delaware Court of Chancery Concludes that Knauf Was Not an Interested Stockholder under the Delaware Business Combination Statute, Allowing USG-Knauf Merger Vote to Proceed

ON SEPTEMBER 25, 2018, the Delaware Court of Chancery denied a preliminary injunction motion that would have prevented the stockholder vote on the $7 billion merger between USG Corporation and Gebr. Knauf AG, finding that Knauf was not an "interested stockholder" within the meaning of Section 203 of the DGCL.

As a threshold matter, USG was governed by Section 203 of the DGCL (i.e., USG had not opted out of Section 203 in its certificate of incorporation). Section 203 prohibits a corporation from engaging in a business combination with an "interested stockholder" for a period of three years following the time that the stockholder became an interested stockholder, unless the business combination is approved in a prescribed manner. Under Section 203, an interested stockholder is a person who owns 15% or more of the outstanding voting stock of the corporation. The provision extends to "a person that individually or with or through any of its affiliates or associates…has any agreement, arrangement or understanding for the purpose of acquiring, holding, voting…or disposing of such stock with any other person that beneficially owns, or whose affiliates or associates beneficially own, directly or indirectly, such stock."

The plaintiffs argued that Knauf was an "interested stockholder" within the meaning of Section 203 because, prior to the USG board's approval of the merger, Knauf—which held approximately 10% of USG's common stock—and

Berkshire Hathaway—which held approximately 30% of USG's common stock—allegedly had an ***agreement, arrangement or understanding*** with respect to the merger. As evidence of such an agreement, arrangement or understanding, the plaintiffs cited extensive communications between Knauf and Berkshire representatives before the merger, Berkshire's support of an all-cash offer for USG, Berkshire's support of Knauf's successful campaign against USG's four director nominees (which eventually forced USG to negotiate with Knauf), and the voting agreement with Berkshire and Knauf, which the plaintiffs argued had formalized Berkshire's support of Knauf. Based on these facts, the plaintiffs argued that, because Knauf and Berkshire collectively owned more than 15% of USG's common stock, the merger triggered the requirements of Section 203 of the DGCL and required the affirmative vote of 66-2/3% of the outstanding shares of USG's common stock not owned by Knauf, Berkshire, and their affiliates to complete the merger.

In a bench ruling, Vice Chancellor Glasscock concluded that under Section 203 Knauf did not become an owner of Berkshire's shares of USG common stock because there was no "meeting of the minds" as to an agreement that ceded control of Berkshire's holdings in USG common stock to Knauf. The Court found that Knauf's and Berkshire's interests were congruent, but not identical. The court was persuaded that Berkshire had retained control of its USG stock and was free to pursue its interest based on Berkshire's (1) disclosure of a proposed option deal with Knauf, which Berkshire publicly disclosed against Knauf's objections, (2) encouragement of USG's board of directors to decline Knauf's initial offer, and (3) negotiation of a contractual out in its voting agreement with Knauf in the event another acquisition proposal emerged. The court thus held that Knauf was not an "interested stockholder," and the USG-Knauf merger transaction was not subject to the requirements of Section 203.

Transcript of Telephonic Ruling, *In re USG Corp. S'holder Litig.*, C.A. 2018-0602-SG (Del. Ch. Sept. 25, 2018).

Delaware Chancery Finds Material Adverse Effect – Allows Fresenius to Walk Away from Its Agreed $4.75 Billion Purchase of Generic Drug Maker

ON OCTOBER 1, 2018, the Delaware Court of Chancery issued its opinion in *Akorn, Inc. v. Fresenius Kabi AG*, finding that Fresenius validly terminated its merger agreement to acquire specialty generic pharmaceutical manufacturer Akorn, Inc., in a deal valued at $4.75 billion. Vice Chancellor Travis Laster took the rare step of approving a buyer's termination of its merger agreement, based on his findings that Akorn (1) suffered a material adverse effect ("MAE"), (2) breached certain representations, and (3) failed to operate in the normal course of business.

The ruling is stark against the backdrop of past Delaware cases, which have *never before* found the existence of an MAE that would excuse a buyer from closing. In his 246-page opinion, Vice Chancellor Laster acknowledges the past precedent disfavoring termination of merger agreements on account of "buyer's remorse," and details what the court believed were unique circumstances facing Akorn that make this case different. Specifically, the Court found that Akorn experienced a sustained downturn in its financial performance and characterized regulatory issues as "systemic" failures that materially threatened Akorn's long-term earnings potential.

Fresenius and Akorn signed the merger agreement on April 24, 2017 with an anticipated closing one year later. The agreement had standard closing conditions, allowing Fresenius to terminate the deal if Akorn's representations were not true at closing to an extent that would be expected to constitute an MAE or if Akorn materially failed to operate in the ordinary course of business between signing and closing. Fresenius was also not required to close the transaction if an MAE occurred.

Shortly after signing, Akorn suffered a significant downturn in financial results over three quarters. By the end of 2017, Akorn's EBITDA was down 86% from its year-end EBITDA in 2016, which Akorn attributed to increased competition and supply disruptions. Pointing to these and

other developments, Fresenius gave notice that it was terminating the merger agreement on April 22, 2018, and Akorn filed suit for specific performance the next day.

After a five-day trial, Vice Chancellor Laster determined that Fresenius had validly terminated the agreement. The court found that an MAE occurred because Akorn suffered a "sudden and sustained" downturn, demonstrated by negative performance over the course of nearly a year after signing. In analyzing whether poor performance constitutes an MAE, the Court evaluated Akorn's performance against results during the same quarter of the prior year. In the successive four quarters after signing, Akron's year-over-year decrease in operating income was 84%, 89%, 292%, and 134%, respectively. The decline in earnings per share for each quarter was even higher. The Court also looked at metrics of Akorn's growth, which also dropped sharply.

The Court viewed the downturn as not only "durationally significant," but also as showing "no signs of abating," and further stated that Akorn's management team provided "reasons for the decline that can reasonably be expected to have durationally significant effects." While the MAE definition carved out industry-wide factors, the Court found the industry-wide carveout inapplicable on the grounds that increased competition disproportionately affected the drugs in Akorn's portfolio.

The Court also reviewed certain regulatory issues and concluded that Akorn had breached its regulatory compliance representation, which the Court found prevented Akorn from satisfying its MAE-qualified "bring-down" condition. While acknowledging that the full impact of these problems had still not materialized by the time of trial, the Court held that an MAE can be based on prospective future harm to the business, and can have occurred "without the effect on the target's business being felt yet." The Court concluded that the potential impact of regulatory issues was material and supported a separate MAE.

The Court also found that Akorn breached its obligation to use "commercially reasonable efforts to operate in the ordinary course of business in all material respects" because, in the Court's view, the actions Akorn took with respect to certain quality control issues after signing departed "from the ordinary course of business that a generic pharmaceutical company would follow." The Court held that failure to operate in the ordinary course "in all material respects" is a different and lower bar of materiality than an MAE, and that a breach of this covenant occurs "if the deviation from ordinary course practice was significant."

Akorn has appealed the decision to the Delaware Supreme Court so this may not be the last word on this decision. Assuming the *Akorn* decision survives appeal, the unusually long period between signing and closing in the case may limit its precedential utility in future disputes in which a party seeks to avoid consummating a merger agreement based on disappointing pre-closing financial performance. On the other hand, it would be unsurprising to see parties attempt to use the case as a roadmap for arguing that alleged regulatory violations can establish an MAE or violation of an ordinary course covenant, even if actual regulatory problems have not materialized and any harm to the business is purely "prospective" as of the time of the purported termination of the agreement.

Akorn, Inc. v. Fresenius Kabi AG, C.A. No. 2018-0300-JTL (Del. Ch. Oct. 1, 2018)

Chancery Court Applies MFW Framework to Related Party Transaction

IN OLENIK V. LOZINSKI, Vice Chancellor Slights applied the framework established by the Delaware Supreme Court in *Kahn v. M&F Worldwide Corp.*, finding that a merger transaction with a controlling private equity fund on both sides was entitled to business judgment review. The decision helpfully outlines the elements of the *MFW* "roadmap" and clarifies that its "*ab initio*" requirement only requires that the *MFW* elements be in place prior to the commencement of negotiations that, if accepted, would yield an agreement of the parties.

The private equity fund EnCap Investments, L.P. owned two portfolio companies, Earthstone Energy, Inc. and Bold Energy. EnCap believed Bold may be an attractive acquisition target for Earthstone, so EnCap provided Earthstone with diligence materials concerning Bold, and representatives of management of Earthstone, Bold and EnCap met to discuss a potential transaction. After the meeting, Earthstone's board formed a special committee consisting of the two independent directors, which submitted a formal offer letter to acquire Bold that expressly conditioned the offer upon (1) final approval of the special committee and (2) approval of a majority of Earthstone's stockholders not affiliated with EnCap.

The negotiations continued and Bold and Earthstone ultimately entered into a transaction that was overwhelmingly approved by the disinterested stockholders. The transaction nonetheless was challenged in a derivative suit brought against Earthstone and the members of its board of directors, where the plaintiff alleged breach of fiduciary duty and related aiding and abetting claims.

In *MFW*, the Delaware Supreme Court held that a court will review a merger transaction involving a controlling stockholder under the more lenient business judgment rule if the proposed transaction is expressly conditioned, a*b initio*, upon the informed approval of (i) a fully empowered independent committee that has properly exercised its duty of care; and (ii) a majority of the minority stockholders who are free of coercion. *MFW* rejects the argument that all controlling stockholder transactions are conflicted and instead provides a framework that, when followed, "mimic[s] arm's-length dealings" and avoids the conflicts of interests that necessitate fact intensive entire fairness review.

Delaware Enacts Amendments Applying Market-Out Exception to Appraisal Rights for Section 251(h) Mergers

In July 2018, Delaware Governor John Carney signed into law amendments to the Delaware Limited Liability Company Act and the DGCL, which took effect on August 1, 2018. Notably, the amendments expanded the application of the "market out" exception to appraisal rights, which has long been applicable to "long-form" mergers (mergers in which the stockholders of a target company vote to approve the transaction), to also include "medium-form" mergers (mergers that occur following a tender offer with a separate stockholder vote) effected pursuant to DGCL Section 251(h). As a result, appraisal rights will no longer be available in connection with Section 251(h) mergers to stockholders of a target company listed on a national securities exchange or held of record by more than 2,000 holders if the merger consideration received for such shares consists solely of (1) stock (or depositary receipts thereof) of the surviving company, or stock of any company that is listed on a national securities exchange or held of record by more than 2,000 holders, (2) cash in lieu of fractional shares or depositary receipts, or (3) any combination of (1) or (2). Eliminating the inconsistency between the rule applicable to long-form and medium-form mergers may increase the utility of the Section 251(h) structure in stock-for-stock transactions; however, the securities registration requirements for such a transaction erode its timing advantage over long-form mergers.

Separately, DGCL Section 262(e) was amended to provide that, where a statement is given to stockholders seeking appraisal in the context of a Section 251(h) merger, the surviving company must set forth the aggregate number of shares that are not tendered for purchase or exchange, rather than the shares not voted for the merger, for which appraisal has been demanded.

Plaintiffs argued that the "*ab initio*" *MFW* condition was not satisfied because deal discussions began before Earthstone had empowered a special committee and conditioned the deal on an informed vote of the special committee and disinterested stockholders. The Court rejected this argument and concluded that the preliminary discussions prior to the offer letter "never rose to the level of bargaining" and were "entirely exploratory in nature." The Court emphasized the distinction between "discussions" regarding the possibility of a deal and "negotiations" of a proposed transaction. The court held that "negotiations" only take place when a "proposal is made by one party which, if accepted by the counter-party, would constitute an agreement between the parties regarding the contemplated transaction." As such, because Earthstone's offer letter marked the beginning of negotiations between the parties, the inclusion in the offer letter of the express conditions of *MFW* satisfied the "*ab initio*" condition.

Plaintiffs further contended that the participation of Earthstone's Chief Executive Officer and Chairman—who had ties to the special committee members—in negotiations with Bold demonstrated that the special committee was not independent, well-functioning and fully empowered. The Court rejected this argument and held that without allegations of materiality, mere social and financial ties between the independent directors and the counterparty did not give a basis for the plaintiffs' claim. In sum, the Court found that the "telltale signs of a well-functioning special committee—independence, full and unfettered negotiating authority and careful deliberation—[were] all present" and that the committee had satisfied its duty of care such that plaintiff could not plead gross negligence.

Olenik v. Lodzinski, C.A. No. 2017-0414-JRS (Del. Ch. Jul. 20, 2017).

Chancery Court Finds Minority Stockholder Liable as a Controller for Abusing Consent Rights

ON JULY 6, 2018, the Delaware Court of Chancery handed down a decision ordering Chester Davenport and his investment fund, Georgetown Basho Investors, LLC ("Georgetown"), to pay over $20 million in damages to a group of investors in Basho Technologies, Inc. ("Basho"). The Court found that Georgetown, a large investor in Basho, caused Basho to engage in an oppressive financing transaction with Georgetown using "hardball" negotiating tactics. The case is notable because it found that Georgetown controlled Basho with respect to the financing transaction—even though Georgetown did not have a majority of Basho's voting power at the time—based in part on Georgetown's contractual consent rights over extraordinary corporate actions.

> "**Although this decision** did find that a minority stockholder exercised actual control over a company, and the contractual consent rights that the court relied on are commonplace for large investors, the import of the decision may still be relatively limited."

From 2010 to 2013, Georgetown led a series of preferred stock financings for Basho, through which Georgetown gained contractual consent rights over extraordinary corporate transactions, including attempts by the company to raise outside funding. In 2013, when Basho was in a "position of maximum financial distress," the Court found that Georgetown "forced through" a Series G financing round that was highly favorable to Georgetown (giving it voting control) and unfair to Basho's other investors (Basho was provided only $2.5 million in new money, and was required to pay Georgetown a significant annual management fee). The Court found that Georgetown then caused Basho to engage in a number of self-dealing transactions and turned down sources of capital that would have undermined Georgetown's control. Ultimately, in 2016, Basho went into receivership and was liquidated.

Other investors in Basho sued Georgetown and its director designees for breach of fiduciary duty based on their conduct in connection with and following the Series G Financing.

The Court found that Georgetown exercised "actual control" over Basho in connection with the Series G Financing due to a "confluence of multiple sources of influence." In addition to considering the contractual rights Georgetown used to block "other financing alternatives," the Court focused on the "coordinated actions" of Georgetown's representatives to spread "misinformation" about Georgetown's intentions to Basho and rival bidders, and the "threats" about negative consequences to Basho and its directors if they did not approve the financing. Based on these factors, among others, the court concluded that Georgetown owed a fiduciary duty to the company's other investors in connection with the Series G Financing, and that it breached this duty because the financing was unfair.

Although this decision did find that a minority stockholder exercised actual control over a company, and the contractual consent rights that the Court relied on are commonplace for large investors, the import of the decision may still be relatively limited. The Court was careful to stress the "egregious" nature of Georgetown's conduct, and relied on a number of factors in addition to Georgetown's contractual consent rights in finding control. Accordingly, it will likely remain an uphill battle for stockholder-plaintiffs to bring breach of fiduciary duty claims against minority investors, even if those investors have contractual consent rights over corporate actions.

Basho Technologies Holdco B, LLC v. Georgetown Basho Investors, LLC, C.A. No. 11802-VCL (Del. Ch. July 6, 2018).

Delaware Court of Chancery Provides Further Guidance on Applicability of Transaction Price as Measure of Fair Value in Two Appraisal Decisions

TWO DELAWARE APPRAISAL DECISIONS issued during the third quarter of 2018 illustrate that, following the Delaware Supreme Court's decisions in *Dell* and *DFC*, Delaware courts remain willing to give substantial evidentiary weight to the deal price as an indicator of fair value where the underlying transaction was the product of an open process characterized by objective indicia of reliability. Conversely, Delaware courts may place lower evidentiary weight on the deal price where the transaction appears not to have resulted from a process subject to a full market review.

> "**Delaware courts** remain willing to give substantial evidentiary weight to the deal price as an indicator of fair value where the underlying transaction was the product of an open process characterized by objective indicia of reliability."

In his July 30, 2018 decision for *In re Appraisal of Solera Holdings, Inc.*, Chancellor Bouchard of the Delaware Court of Chancery applied the market efficiency principles endorsed by *Dell* and *DFC* in holding that the fair value of the petitioners' shares was the deal price of $55.85 per share less $1.90 per share of estimated merger synergies. Solera, a global leader in the data and software industry, was acquired by an affiliate of Vista Equity Partners for $55.85 per share in cash. The merger was the product of a two-month outreach to potential financial buyers, a six-week auction conducted by an independent and fully empowered special committee, and ongoing public disclosures relating to the sale process. In addition, the merger agreement permitted a 28-day go-shop, which afforded favor-

able terms to allow a key potential buyer (and competitor) of Solera to bid for the company.

Chancellor Bouchard found that the Solera merger resulted from a transaction process that had the requisite objective indicia of reliability emphasized by *DFC* and *Dell*: robust public information concerning the company's stock price, a relatively unrestricted auction process, multiple parties with incentive to profit and opportunity to bid, an empowered special committee consisting of independent, experienced directors, and no disabling conflicts of interest for negotiators that compromised the sale process. The Chancellor therefore concluded that the deal price, minus synergies, was the best evidence of fair value and deserved dispositive weight in the appraisal valuation.

That same week, on July 27, 2018, the Delaware Court of Chancery issued its post-trial opinion in *Blueblade Capital Opportunities LLC v. Norcraft Companies, Inc.*, an appraisal litigation concerning the May 2015 acquisition of Norcraft, a cabinet manufacturer and retailer for new home construction and existing home remodeling markets, by Fortune Brands Home & Security, Inc. for $25.50 per share in cash. In the decision, Vice Chancellor Slights found the single-bidder pre-signing process did not provide a pre-signing market check. He also concluded that certain of the deal protection measures negotiated in the transaction would not support reliance on the transaction price as the best measure of Norcraft's fair value. In addition, given the relative absence of record evidence regarding the efficiency of the market for Norcraft's common stock, the court was unwilling to adopt the pre-merger trading price of the company's stock as a reliable indicator of fair value.

Given those findings, Vice Chancellor Slights conducted an independent discounted cash flow ("DCF") analysis, which was based on the company's base case projections and which adopted certain assumptions and inputs reflected by the parties' respective expert witnesses. Relying on that DCF analysis, while considering the variance of the result from the merger price as a "reality check," the Vice Chancellor concluded that the fair value of Norcraft's stock was $26.16 per share. This was a slight premium to the trans-

Chancery Court Revisits Fair Value Analysis in AOL Appraisal Action

On February 23, 2018, the Delaware Court of Chancery issued its original opinion in a consolidated appraisal action arising out of Verizon Communications Inc.'s 2015 acquisition of AOL Inc. In contrast to a recent string of Delaware appraisal decisions, the court determined that reliance on the $50 per share merger price for determining AOL's statutory fair value was not warranted, in light of deal protection devices contained in the merger agreement and AOL CEO's post-signing statements signaling to market participants that the transaction was a "done deal." Instead, the Court utilized a DCF analysis to conclude that fair value of an AOL share was $48.70—a 2.6% discount to the deal price. That fair value determination included $2.57 per share that the Court added to its DCF analysis, in an effort to account for pending AOL transactions not yet consummated as of the merger's closing. Both parties filed motions for reargument. AOL claimed that the accretive value of the potential transactions should have been lower; the plaintiffs argued the value should have been higher and that the Court should include the projected revenue of the pending transactions through the DCF analysis.

The Court ruled on the motions for reargument on August 15, 2018, concluding that its previous determination of the accretive value of one of the pending transactions—the "Display Deal"—was based on an error of fact. The Court recalculated the present value of the Display Deal at $85.1 million and added that amount to its DCF valuation, to conclude that the fair value of AOL was $47.08 per share—$1.62 less than its original finding, and nearly 6% below the deal price. The Court observed that "[n]o DCF analysis . . . can be sufficiently rigorous that it will not permit a good-faith argument that the value should be otherwise." The decision nonetheless cautioned that courts "must resist the desire to achieve the 'right' number in a financial analysis . . . by revisiting such discretionary decisions in a way that encourages run-on litigation." The Court's decision highlights the uncertainties inherent in DCF valuations, and, while the Court adjusted its initial valuation, it indicated that the Court of Chancery should ordinarily be reluctant to revisit fair value determinations based on the parties' quibbles with underlying assumptions.

In *re Appraisal of AOL Inc.*, C.A. No. 11204-VCG (Del. Ch. Aug. 15, 2018).

OTHER **KEY DECISIONS** *(continued from page 10)*

Appraisal Notice Requirements

Cirillo Family Trust v. Moezinia relates to the acquisition of DAVA Pharmaceuticals by an affiliate of Endo Pharmaceuticals. The merger required the approval of DAVA's stockholders, which DAVA obtained via written consents from 99.73% of DAVA's stockholders. After one holdout stockholder, Cirillo Family Trust, refused to sign the stockholder written consent, DAVA sent Cirillo a notice pursuant to Sections 228 and 262 of the DGCL that the merger had been approved by the requisite percentage of DAVA's stockholders and Cirillo had the right to seek an appraisal of its DAVA shares. The notice, however, did not include a description of DAVA's business, financial information or prospects, or any information on how the merger consideration was determined. Cirillo sued DAVA's directors, claiming, *inter alia*, that the directors breached their fiduciary duties and engaged in bad faith by not disclosing material information in the notice in accordance with Delaware law.

Chancellor Bouchard agreed that the notice provided to DAVA was "totally bereft of information required under Delaware law" and reiterated that directors have a fiduciary duty to exercise due care, good faith and loyalty in communications with shareholders. However, the Court of Chancery granted summary judgment to the directors based on its determination that (1) they were not conflicted and did not act in bad faith in reasonably relying upon legal counsel to prepare the notice in compliance with Delaware law, and (2) the directors were exculpated in the company's certificate of incorporation as permitted under Section 102(b)(7) of the DGCL. The Chancery Court also determined that Section 141(e) of the DGCL acted as a safe harbor and "fully protected" the directors against personal liability since the directors relied in good faith upon the advice of counsel with professional or expert competence in preparing the notice.

The Cirillo Family Trust v. Moezinia, C.A. No. 10116-CB (Del. Ch. July 11, 2018).

action price of $25.50, but materially below the $34.78 per share valuation suggested by the petitioners.

Importantly, the courts in both *Solera* and *Norcraft* expressed their displeasure with what they perceived to be the practice of parties in appraisal actions offering expert valuations that appear to be results-oriented because they skew heavily towards the parties' respective legal positions. In particular, Chancellor Bouchard's decision in *Solera* emphasized that a DCF that produces a valuation that is drastically different from the transaction price may lack credibility on its face. Vice Chancellor Slights also critiqued the parties' respective valuation experts for making choices in their DCF analyses that were not supported, in the Court's view, by the evidence or accepted financial principles.

Blueblade Capital Opportunities LLC, et al. v. Norcraft Companies, Inc., C.A. No. 11184-VCS (Del. Ch. July 27, 2018); *In re Appraisal of Solera Holdings, Inc.*, C.A. No. 12080-CB (Del. Ch. July 30, 2018)).

Addressing #MeToo in Mergers & Acquisitions

TURN ON A TELEVISION, pick up a newspaper, or scroll through social media, and you are bound to come across a story related to the #MeToo movement. Allegations of sexual harassment, sex-based discrimination and sexual misconduct have dominated the headlines, but the effect of this movement goes far beyond the entertainment and media industries. Publicly traded and privately held companies in all industries are facing heightened reputational and legal risks, as employees are more likely to identify and report instances of misconduct or discrimination in the workplace (and such instances are more likely to become public). In the world of mergers and acquisitions, reputational and legal risks are ultimately risks to the bottom line—prompting private equity sponsors, institutional investors and strategic purchasers to focus on #MeToo issues when sourcing, diligencing and negotiating investments.

CORPORATE EXPOSURE

In addition to incurring reputational harm when allegations of unlawful misconduct or discrimination become public (through a lawsuit or otherwise), an employer also faces potentially significant legal exposure when such claims are raised. Under Title VII of the federal Civil Rights Act and similar state laws, employers can be vicariously liable for a supervisor's acts of sexual harassment, and may also be liable for such acts by non-supervisory employees (or even non-employee service providers). Remedies for violations of these laws include back pay, front pay, reinstatement, punitive damages, compensatory damages (for example, damages for emotional distress and medical treatment), and attorneys' fees. Relatedly, accused employees may bring wrongful termination claims based on allegations that an employer mishandled the investigation of a complaint against them, which further counsels for exercising care in investigating such allegations.

And legal exposure is not limited to traditional, direct claims under employment laws. Companies also face indirect civil liability for sexual harassment, sex-based discrimination or sexual misconduct. For example, shareholders of public companies have brought derivative suits alleging breaches of fiduciary duties in connection with sexual harassment allegations against key executives. In other cases, plaintiffs have asserted single-employer and corporate veil piercing theories (with varying degrees of success) in an attempt to hold parent companies or investors responsible for sexual harassment that occurs at a subsidiary or portfolio company.

As the #MeToo era continues to unfold, the plaintiffs' bar is likely to become more aggressive and creative with their claims, while government agencies (including state attorney general offices) may become more rigorous in their efforts to enforce anti-harassment and anti-discrimination laws. Meanwhile, the departure of executives who engaged in misconduct but were otherwise critical to the business, can hurtle companies into disarray, and key customer relationships can disintegrate amidst negative publicity or industry chatter. Finally, allegations in this area can lower employee morale and productivity, and can make recruitment of talented individuals more challenging. The takeaway is clear for investors, strategic purchasers, and target companies alike: companies that do not adequately prevent or respond to allegations of unlawful misconduct or discrimination may be risky investments.

TRANSACTIONAL #METOO CHECKLIST

In light of these risks, investors and strategic purchasers in all sectors should give appropriate weight to #MeToo issues throughout the deal process, from sourcing to consummation. The market has started to reflect this new focus—for example, it is becoming increasingly common to see representations and warranties that specifically reference sexual harassment claims, investigations and settlements, even in more competitive auction processes. To that end, the following checklist outlines certain steps that buyers (and their advisors) can take to better identify these issues and mitigate the related risks.

- **Targeted diligence review:** Enhancements or "add-ons" to the standard diligence process include (i) asking specific questions about allegations, investigations and settlements to identify issues that have not resulted in formal litigation, (ii) inquiring about executives or key employees who have

been the subject of sexual harassment, sex-based discrimination or sexual misconduct allegations, as well as any employees who have been the subject of more than one such allegation, (iii) requesting harassment prevention policies and information about reporting procedures (e.g., employee hotlines) to identify potential weaknesses, (iv) reviewing claims histories under employment practices liability insurance policies and (v) surveying workplace reviews on websites such as Glassdoor.

- **Stronger contractual protections:** In a purchase or merger agreement, general litigation representations (which typically have materiality qualifiers and may be limited to formal and/or pending actions) may not be broad enough to pick up "mere" allegations and settlements, which can be critical in identifying a problematic executive or workplace culture. Specific representations that drive disclosure of these issues—with lookbacks and without materiality qualifiers—are being seen more frequently. Additionally, it may be prudent to include #MeToo-specific protections for the period between signing and closing, such as a notification requirement with respect to any allegations against executives or key employees and a consent requirement with respect to any settlements.

- **Broader background checks:** Background check vendors who are engaged for a transaction generally can be instructed to investigate workplace culture specifically, including through employee engagement surveys. Background checks also can be conducted on individual executives or key employees (subject to applicable law) and include specific checks into matters related to sexual harassment, sex-based discrimination or sexual misconduct.

- **Tailored management arrangements:** When employment agreements and equity awards are negotiated in connection with a transaction, buyers should consider requiring that the applicable documents include a representation that the executive or key employee has never been the subject of a sexual harassment, sex-based discrimination or sexual misconduct allegation, including at any prior employer. Any "cause" definition could be drafted so that a breach of that representation would be grounds for immediate termination of employment (without payment of severance and with forfeiture of any equity on bad leaver terms). Structuring management arrangements with #MeToo issues in mind can help companies avoid a scenario in which an employee who is fired for misconduct is entitled to receive significant financial benefits in connection with his or her departure and retain equity following departure (consequences which may, among other concerns, present significant public relations difficulties).

> "**The takeaway** is clear for investors, strategic purchasers, and target companies alike: companies that do not adequately prevent or respond to allegations of unlawful misconduct or discrimination may be risky investments."

BEYOND CLOSING

Of course, attention to #MeToo issues in the transactional context should not end when a deal closes. Post-closing, investors may wish to ensure that companies have appropriately shored up harassment prevention and other employment policies, are delivering harassment prevention trainings to managers and other employees (which is legally required in some states), have set up adequate reporting procedures, and are investigating and responding appropriately to allegations of misconduct. These ongoing investments in workplace culture can reap significant benefits—higher morale and employee productivity, fewer resources channeled towards defending claims, and ultimately, a stronger bottom line.

Landmark CFIUS Reform Enacted

ON AUGUST 13, 2018, President Trump signed into law the Foreign Investment Risk Review Modernization Act ("FIRRMA"), which was incorporated into the Fiscal 2019 National Defense Authorization Act. FIRRMA broadens the authority of the Committee on Foreign Investment in the United States ("CFIUS") to determine whether foreign investments in U.S. businesses pose a risk to national security and represents the most significant effort to revise the CFIUS process in more than a decade. Among other things, FIRMMA expands the scope of transactions potentially subject to CFIUS review, requires mandatory filing for certain transactions involving foreign government-affiliated investors, and grants CFIUS the authority to suspend transactions mid-investigation. Although it will take time to determine the full effect of the new law, it is foreseeable that FIRRMA could present significant new obstacles to foreign investment in the United States.

> "**Although it will take time** to determine the full effect of the new law, it is foreseeable that FIRRMA could present significant new obstacles to foreign investment in the United States."

CFIUS has the authority to review any "covered transaction" which, prior to FIRRMA, meant "any transaction . . . by or with any foreign person which could result in control of a U.S. business by a foreign person." Historically, the CFIUS review process has been voluntary, and parties to a covered transaction were not required to notify CFIUS of the transaction unless specifically directed by CFIUS. CFIUS may impose mitigating measures on the parties to a covered transaction—or recommend that the President block a transaction entirely—if CFIUS determines that the foreign investment threatens to impair U.S. national security.

FIRRMA introduces several major changes to key aspects of CFIUS's review authority and process. Below is a brief outline of these major changes; for more information on FIRRMA, please see the Ropes & Gray client alert available here. FIRRMA:

- Extends CFIUS's jurisdiction to any non-passive foreign investments in a U.S. "critical technology company" or "critical infrastructure company";
- Broadens the definition of "critical technology" to include emerging technologies;
- Codifies CFIUS's focus on the acquisition of personal identifiable information of U.S. citizens;
- Makes certain real estate transactions subject to review;
- Clarifies that changes in rights can constitute a covered transaction;
- Makes certain bankruptcy-related transactions subject to review;
- Clarifies treatment of certain indirect investment fund investments;
- Makes certain filings mandatory;
- Extends the review process for most investors;
- Imposes a filing fee;
- Exempts intellectual property licensing and support transactions;
- Clarifies unilateral review of transactions; and
- Addresses attempts to circumvent or evade CFIUS review.

Transactions completed before August 13, 2018 (the date of enactment) are not subject to the new law. However, FIRRMA generally applies to any covered transaction for which CFIUS has not initiated an investigation or review, meaning, importantly, that certain key provisions—such as the modification of what qualifies as "critical technology"—apply immediately. The new law's mandatory filing requirements and the new rules with respect to real estate—will not take effect until the earlier of (i) the date that is 18 months after enactment, or (ii) 30 days after the Secretary of the Treasury certifies that the new regulations, and the organizational resources called for by the bill, are in place.

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Importantly, FIRRMA authorized CFIUS to conduct "pilot programs" to implement earlier those aspects of FIRRMA that did not take immediate effect. On October 10, 2018, the U.S. Department of the Treasury issued temporary regulations—a "pilot program"—to implement certain provisions of FIRRMA. The announcement of this pilot program, which will take effect on November 10, 2018, represents a dramatic and rapid assertion by CFIUS of new authority granted to it under FIRRMA. Under the pilot program, non-controlling foreign investments in certain U.S. industries (electronics, chemical, and semiconductor manufacturing, and research and development in biotechnology, among others)—which, prior to FIRRMA, were outside the scope of CFIUS's jurisdiction—will be subject to mandatory CFIUS notification (at risk of significant penalty).

DOJ Commentary Underscores the Importance of Pre-Acquisition Diligence

IN A JULY 2018 SPEECH at a conference, the U.S. DOJ Deputy Assistant Attorney General for the Criminal Division ("DAAG") underscored the importance of pre-acquisition Foreign Corrupt Practices Act ("FCPA") diligence. The DAAG's remarks reinforced FCPA enforcement as a DOJ priority, and provided a disclosure road map for buyers who uncover FCPA-related misconduct both pre- and post-acquisition. These statements were consistent with the DOJ's continuing efforts to provide clearer guidance and more consistent outcomes in FCPA enforcement.

The DAAG stated that the DOJ remains committed to "fighting corruption and ensuring a level playing field for law-abiding companies" in a way that is "fair and just." In the transactional context, law-abiding companies may inherit historical misconduct that their compliance program had no opportunity to discover and remediate.

The DAAG suggested that buyers that uncover FCPA misconduct pre-acquisition should consider seeking guidance from the DOJ before completing the purchase using the DOJ's FCPA Opinion Procedures. Under the FCPA Opinion Procedures, companies may submit a written request to the DOJ's Criminal Division for an opinion as to whether certain specified conduct conforms with the DOJ's FCPA enforcement policy. The DOJ technically has 30 days to respond to a request, although in practice the process typically takes much longer. The DAAG noted that the DOJ could expedite its analysis based on timing needs, but that "it sometimes makes sense to slow down to assess risks." Notably, however, the DOJ has not issued an advisory opinion since 2014.

> "**Regardless, it is clear** from the commentary that the DOJ expects companies to conduct meaningful pre- and post-acquisition diligence. If misconduct is identified, the buyer should begin remediation and weigh whether, and to what extent, it wants to engage in discussions with the DOJ."

According to the DAAG, for misconduct identified post-acquisition, buyers that follow the steps outlined in the DOJ's FCPA Policy will be rewarded for "stepping up, being transparent, and reporting and remediating the problems inherited." Accordingly, post-closing, successor entities that uncover historical misconduct should be mindful of the FCPA Policy's incentives for self-disclosure, full cooperation, and timely and appropriate remediation. Companies that comply with the policy can be rewarded with significantly discounted financial penalties, up to and including a complete declination from the DOJ.

The DAAG added that where the DOJ declines to take action against an acquired entity, individual wrongdoers will not receive a free "pass for corrupt behavior " and the DOJ will investigate and prosecute, where appropriate, individuals who are responsible for carrying out or concealing the historical wrongdoing.

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By establishing a clear enforcement framework in the mergers and acquisitions context, the DAAG said that the DOJ is encouraging U.S. foreign investment in high-risk jurisdictions. Indeed, the DAAG noted that incentivizing high-risk acquisitions by law-abiding companies helps the DOJ "stamp out corruption." Law-abiding companies that conduct robust diligence, self-disclose and remediate the misconduct, and cooperate with the DOJ, free up DOJ resources, according to the DAAG.

The DAAG's commentary also emphasizes the importance of both pre- and post-acquisition diligence. The DOJ continues to see FCPA enforcement as a collaborative process where the DOJ is viewed as a "partner, not just an adversary." Regardless, it is clear from the commentary that the DOJ expects companies to conduct meaningful pre- and post-acquisition diligence. If misconduct is identified, the buyer should begin remediation and weigh whether, and to what extent, it wants to engage in discussions with the DOJ.

Ropes & Gray will continue to monitor the DOJ's activities in the mergers and acquisitions space.

IRS Considers Giving More Ventures Access to Tax-Free Spinoffs

ON SEPTEMBER 25, 2018, the IRS announced that it is considering guidance on the treatment of spinoffs involving business ventures engaged in research and development for future profit. The announcement is of special interest to life sciences and other technology ventures actively engaged in R&D for new pharmaceutical, medical device or other technology-based products. In particular, the announcement addresses situations where a company seeks to spin off a historic R&D-based business before its intellectual property has been fully developed or commercialized.

A corporate separation must meet several requirements to qualify as a tax-free spinoff, including that both the distributing parent corporation and the spun-off controlled corporation be engaged, immediately after the distribution, in "active trades or businesses" conducted for a minimum of five years. Applicable Treasury regulations provide that an active trade or business "ordinarily must include the collection of income and the payment of expenses." While the use of the word "ordinarily" suggests that under current law certain business ventures without revenue can qualify as an "active trade or business," the regulations provide no guidance with respect to situations where the active trade or business requirement would be met without revenue. These regulations date to the mid-1950s, and the existing administrative guidance applying them also predates the emergence of modern-day biotechnology and other high-tech ventures.

The announcement does not propose specific standards for the type of R&D operations that could qualify as an active trade or business, but it notes that these ventures must "incur significant financial expenditures and perform day-to-day operational and managerial functions that historically have evidenced an 'active' business." The emphasis on operational and managerial functions suggests that having employees engaged in management as well as R&D will be critical. The existing regulations treat a business as being actively conducted only if the corporation actively performs the key management and operational functions itself, rather than through independent contractors. This standard is clearly met by biotechnology firms and other technological ventures that bring together research scientists and executives focused on corporate strategy, finance, and other typical management functions. Similarly, the announcement draws a distinction between entrepreneurial activities on the one hand, and investment or other non-business activities on the other.

Significantly, pending completion of its study, the IRS will entertain private letter ruling requests on the issues described in the announcement. This suggests that the IRS believes that under current law at least some businesses without revenue can qualify as active trades or businesses, where every indicator of an active trade or business is present except for the absence of profits in either the parent or the spun-off company following the spinoff. An example might be a spinoff by a mature, revenue-producing technology company of a pre-commercial stage product

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line, where the pre-commercial business has significant numbers of employees engaged in management as well as R&D functions, and the genesis of the pre-commercial stage business is organic and closely intertwined with the mature, revenue-producing portion of the business that will remain with the parent corporation.

The announcement indicates that the IRS welcomes taxpayer comments on these issues, and that it may be willing to revoke existing administrative guidance, provide new affirmative guidance, and consider "whether an exception should apply to any particular business model due to its unique characteristics." Changes such as these may permit tax-free spinoffs in situations that previously were unclear. While it is too early to predict the potential outcome of the IRS's study, the announcement signals recognition of the need to consider how guidance should be understood—or, if necessary, modified—to accommodate 21st-century realities.

Corporate Social Responsibility: California Moves to Promote Greater Gender Diversity on Public Company Boards

ON SEPTEMBER 30, 2018, California Governor Edmund G. Brown Jr. signed into law a measure that requires "a publicly held domestic or foreign corporation whose principal executive offices, according to the corporation's SEC 10-K form, are located in California" to have at least one female director on its board of directors by no later than December 31, 2019. As a result, California is the first state in the country to mandate that public companies (with headquarters located in California) must have a representative number of women serve on their boards of directors.

Under the law, a public company that maintains its principal executive offices within the state of California must have (i) by December 31, 2019, at least one female director on its board of directors, and (ii) by December 31, 2021:

- at least one female director, if its board has four or fewer directors,
- at least two female directors, if its board has five directors, and
- at least three female directors, if its board has six or more directors.

Public companies that fail to comply with these gender diversity requirements would be subject to fines of $100,000 for the first violation and $300,000 for each subsequent violation, and companies that fail to timely file board member information with the California Secretary of State would also be subject to a $100,000 penalty. Under the law, the California Secretary of State is also required to publish an annual report on the compliance of California public companies with these gender diversity requirements.

In signing the bill, Governor Brown acknowledged the "serious legal concerns" and "potential flaws" of the law. However, California's legislative efforts to promote greater gender diversity on public company boards should be considered within the context of the broader corporate governance trend that has urged greater boardroom diversity. Notably, several European countries, including France, Germany, Italy, the Netherlands, Norway and Spain, have had requirements promoting gender-balanced representation on corporate boards for many years, with Norway first enforcing such requirements for listed companies in 2008. Separately, in recent years, large institutional investors such as BlackRock, State Street and Vanguard have also promoted greater gender diversity through shareholder engagement at their portfolio companies, and continue to ramp up their efforts to promote gender diversity. In addition, by repeating last year's questions on gender diversity in its annual policy survey, ISS may formalize its gender diversity policy into proxy voting recommendations for the 2019 proxy season.

Foreign Investment Controls in the United Kingdom

OVERVIEW

The UK Government is seeking to introduce a new regime that will permit it to review transactions on national security grounds. The proposals are currently subject to consultation, and so the precise scope, extent and timing of any future regime are not yet settled.

The proposals confirm that whilst the UK Government is committed to an open approach to international investment, any such approach must include appropriate safeguards to protect national security and the safety of UK citizens. The need for a more evolved regime in this respect is stated to come as a direct response to technological, economic and geopolitical advances, which necessitate the UK Government having more specific and sophisticated powers at its disposal to scrutinize investments and other events on national security grounds. The proposed reforms are focused on the protection of national security from hostile actors' acquisition of control over entities and/or assets. The UK Government's commentary notes that these risks may be likely to arise in certain critical sectors, namely, national infrastructure, advanced technologies and services that are critical to the UK Government and emergency services.

The proposed UK reforms are not in isolation. These reforms will bring the UK closer in line with other countries' regimes, and are taking place as many other governments are also updating their powers in light of the same technological, economic and national security related changes.

NEW FOREIGN DIRECT INVESTMENT REGIME: THE KEY PROPOSALS

The UK Government is proposing to introduce a voluntary notification system (as per the approach that currently applies under the Enterprise Act 2002), and will encourage notifications from parties who consider that their transaction or other event may prompt national security concerns.

Key aspects of the proposed regime are as follows:

- The new regime will apply where an investment (or other "trigger event") may give rise to national security concerns. In such circumstances, the parties will be encouraged to submit a voluntary notification. The UK Government has published a draft statement of policy intent, which describes where and how it considers that these national security concerns are most likely to arise.

- Currently, the proposals envisage that the parties to the transaction will be able to discuss the proposed activity informally with UK Government officials to assess whether (or not) to submit a formal notification.

- Whilst a voluntary as opposed to a mandatory regime is proposed, the UK Government will, nonetheless, have the power to "call in" any trigger event that raises national security concerns, including those which have not been the subject of any notifications. It will have the power to do this when the trigger event is in contemplation, in progress or within a prescribed period of time after the trigger event has taken place (currently anticipated to be six months). To this end, the UK Government is proposing to increase resources dedicated to market monitoring; and it will also have the powers to request information in relation to specific trigger events that the UK Government is aware of, in order to inform its decision as to whether to call in a trigger event for screening.

- The UK Government's initial analysis is that around 200 notifications will be made under this regime each year. Where notifications are submitted, they aim to quickly screen out those transactions that do not give rise to national security concerns. Those notifications that do give rise to national security concerns, including those which have been "called in," will then be subject to a full assessment.

- Once the UK Government has called in a "trigger event" for national security assessment, it will then have a prescribed period of time in which to assess potential national security concerns. At present, it is contemplated that this will be a period of 30 working days, potentially extendable by a further 45 working days.

- If the UK Government concludes that a trigger event does pose a risk to national security, it will be able to impose conditions in order to prevent or mitigate these risks, whilst allowing the trigger event to proceed; or, as a last resort, it will be able to block or unwind the trigger event.

- It is anticipated that the legislation that will implement the proposed regime would create a number of sanctions (both civil and criminal) that would apply in the event of non-compliance with conditions that have been imposed in respect of a trigger event, or in respect of other orders (such as information gathering requests) served on parties.

- The proposed reforms will involve removing national security considerations from the Enterprise Act 2002. In other respects, the pre-existing public interest regime would continue.

THE TRIGGER EVENTS

It is worth noting that the reforms will expand the range of circumstances where the UK Government has powers to address national security risks. These "trigger events" cover the range of means by which a hostile actor can acquire the ability to undermine national security in the short or long term. The draft proposals set out the following **trigger events**:

- the acquisition of more than 25% of an entity's shares or votes;

- the acquisition of significant influence or control over an entity;

- further acquisitions of significant influence or control over an entity beyond the above thresholds; and

- the acquisition of more than 50% of an asset (this would include real or personal property, contractual rights and intellectual property) or significant influence or control over the asset.

Some preliminary commentary is provided as to an approach to interpreting "significant influence or control" of an entity. This draws heavily on the statutory guidance for interpreting the term under the PSC regime, the UK's beneficial ownership disclosure rules for persons with significant control over certain UK entities. The guidance for assets is new, but adopts a similar approach.

SUMMARY

Until the consultation process is over, we will not know the details of the proposed regime, or indeed how or when it is to be implemented. That said, it is clear that the UK Government is committed to a programme of foreign direct investment controls where they are likely to have an impact on national security.

SIGNIFICANT **TRANSACTIONS**

Represented Natixis Investment Managers in minority investment in WCM Investment Management

Represented Deutsche Bank as financial advisor to Broadcom in acquisition of CA Technologies

Represented WSP Global Inc. in acquisition of parent company of Louis Berger

Represented Deutsche Bank Securities as financial advisor to Infinity Property and Casualty Corporation in sale to Kemper Corporation

Represented SCIOInspire in sale to EXL Service.com

Represented Veolia North America in acquisition of contract services business of American Water Works Company

BY THE NUMBERS

ROPES & GRAY ACQUISITION TRANSACTIONS—Q3 2018

40+ Deals

$35+ Billion in Acquisition Transactions

15 Cross-Border Deals

12 Countries

15+ Industries

Represented Premier Research International in acquisition of Regulatory Professionals

Represented Atlantic Media, Inc. in sale of Quartz to Uzabase

Represented The Hershey Company in acquisition of Pirate Brands from B&G Foods, Inc.

Represented Cambrex Corporation in acquisition of Halo Pharma

Represented Medtronic in acquisition of Mazor Robotics

Represented Waters Corporation in acquisition of exclusive rights to Desorption Electrospray Ionization technology

Represented MarketCast Group in acquisition of Turnkey Intelligence

Represented The Hillman Group, Inc. in acquisition of Big Time Products

Represented Cirque du Soleil in acquisition of Vstar Entertainment Group

Represented Duckhorn Wine Company in acquisition of Kosta Browne

SIGNIFICANT **TRANSACTIONS**

Represented CCA China in acquisition of Momentum Sports

Represented Bracket Global in acquisition of CRF Health

Represented Eze Software in sale to SS&C Technologies Holdings, Inc.

Represented KPA in majority investment from Providence Equity Partners

Represented New Mountain Capital in investment in Beeline

Represented Epiris Managers LLP in acquisition of Bonhams Brooks PS&N Ltd. from Robert Brooks and the Louwans Family

Director **SUMMIT**

JOIN US for our Director Summit series program on workplace harassment and pay equity.

In the wake of the #MeToo movement and recent developments in the legal and business landscape, directors face challenges arising from the heightened focus on issues of sexual misconduct and workplace harassment, gender pay equity and related matters.

NOVEMBER 13, 2018

Registration: 11:30AM – Noon
Presentation: Noon – 1PM

The Sea by Alexander's Steakhouse
4629 El Camino Real | Palo Alto

RSVP by November 9

LOOK-BACK | Director **Summit**
ESG – Environmental, Social and Governance

For a close-up look at investor expectations, CSR disclosures and the role of the board in ESG, see our full *panel recap*.

ROPES & GRAY | **Questions:** Kelsey Karach kelsey.karach@ropesgray.com

Represented Duke Street Capital in acquisition of Great Rail Journeys

Represented Partners Group in investment in Global Logic

Represented TSG Consumer Partners in investment in Privé Revaux Eyewear

Represented J.W. Childs Associates in acquisition of Walker Edison

Represented Golden Gate Capital in acquisition of The Learning Experience

Represented H.I.G. Capital in sale of AMPAC Fine Chemicals to SK Holdings Co. Ltd.

Represented Welsh, Carson, Anderson & Stowe in acquisition of Abzena plc

Represented Silver Lake Partners in strategic growth investment in GoodRx

Represented The Cranemere Group in acquisition of majority stake in NorthStar Anesthesia

Represented McNally Capital and consortium of family office co-investors in acquisition of Federal Data Systems Inc.

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