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The Ropes Recap

Mergers & Acquisition Law News

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

Contents

Delaware Legislative Update

Amendments to DGCL Effective August 1, 2014

Several amendments to the Delaware General Corporation Law ("DGCL") went into effect on August 1, 2014, most notably amendments to Section 251(h), the "statutory top-up" provision enacted last year. The amendments are designed to eliminate limitations on use of the statutory top-up, including by eliminating the "interested stockholder" prohibition. The changes should further encourage the use of tender offers in connection with acquisitions of public company targets. In addition, amendments to DGCL Section 242 will allow a board to amend a company's Certificate of Incorporation without a stockholder vote to change the corporate name and to make certain technical changes:

- Elimination of the "Interested Stockholder" Prohibition. As originally drafted, Section 251(h) was only available under circumstances in which a transaction did not involve a person who was an "interested stockholder," as such term is defined in DGCL Section 203, at the time the target's board of directors approved the merger agreement. Many practitioners interpreted this provision to preclude use of Section 251(h) under circumstances in which a 15% or more stockholder executed a tender and voting agreement in support of a proposed transaction. As amended, the "interested stockholder" restriction has been deleted from Section 251(h) altogether, thus expanding the availability of the provision.
- Clarification of "Any and All" Shares Requirement. Formerly, Section 251(h) required that tender offers be for "any and all" of the target's voting stock. This requirement has been modified to exclude target stock owned at the commencement of the offer by the acquirer, the target, and certain affiliates of such parties. Moreover, the amendment provides practitioners with additional flexibility with respect to the treatment of such stock in connection with the back-end merger. The practical effect of these changes should be to make the rollover of equity more straightforward in the tender offer context.
- "Guaranteed Delivery" Is No Longer Sufficient. As amended, Section 251(h) now provides that shares of stock tendered into an offer are not counted for purposes of determining whether the tender condition is satisfied unless irrevocably accepted for exchange and received by the depositary before the expiration of the offer (i.e., shares promised to be delivered pursuant to guaranteed delivery procedures can no longer be counted).
- Section 251(h) "Opt-In" No Longer Exclusive. The amendments clarify that while Section 251(h) requires the parties to a merger agreement to explicitly elect to be subject to that provision, such election need not be preclusive to other back-end closing mechanics. As amended, parties to a transaction may now expressly "permit" the use of Section 251(h), while allowing for the potential abandonment of the mechanism in favor of consummation of the transaction under a different statutory provision.

- Amendments to Certificates of Incorporation without Stockholder Approval under 242. DGCL Section 242 has been amended to authorize a corporation to amend its certificate of incorporation without stockholder approval (unless otherwise expressly required by the certificate of incorporation) to (1) change the corporate name, (2) delete historical provisions in the original charter naming the incorporator, the initial board of directors and/or the original subscribers for shares and (3) delete provisions relating to already effected changes in capital stock.

News from the Courts

Additional Guidance on *Kahn v. M&F Worldwide Corp.*

In *Swomley v. Schlecht*, a recent transcript ruling by the Delaware Court of Chancery, Vice Chancellor Laster provided additional guidance on the application of *Kahn v. M&F Worldwide Corp.*, a decision discussed in the April 2014 edition of the *Recap*.

In *Kahn v. M&F Worldwide Corp.*, the Delaware Supreme Court affirmed the Delaware Court of Chancery's decision to apply the deferential business judgment rule, rather than the more exacting "entire fairness standard," to review transactions involving a controlling shareholder. Business judgment rule review was made available provided the deal is conditioned at the outset on both (i) the approval of an independent, adequately-empowered and well-functioning special committee and (ii) the uncoerced, informed vote of a majority of minority stockholders. The Delaware Supreme Court permitted this more deferential approach to reviewing squeeze-out transactions if and only if (i) the controlling stockholder conditions the transaction on the approval of both a special committee and a majority of minority stockholders, (ii) the special committee is independent, (iii) the special committee is empowered to freely select its own advisors and say no definitively, (iv) the special committee fulfills its duty of care in negotiating a fair price, (v) the vote of the minority stockholders is properly informed and (vi) there is no coercion of the minority stockholders.

Kahn v. M&F Worldwide Corp. was welcomed by many practitioners as a way to reduce the leverage plaintiffs held to extract settlements of lawsuits challenging deals, given the time and cost required to defend cases under the "entire fairness" standard. But the decision left open questions regarding whether and how defendants could avail themselves of its protective framework at the pleading stage, using the framework to win dismissal of cases before discovery, particularly in the face of allegations of an inadequate purchase price.

In *Swomley v. Schlecht*, Vice Chancellor Laster provided helpful clarification. Granting a motion to dismiss, the Vice Chancellor held that plaintiffs are required to plead sufficient facts to call into question whether the six factors in the *Kahn v. M&F Worldwide Corp.* framework were met, rather than just to allege that they were not. Vice Chancellor Laster noted that "… the whole point of encouraging the [*Kahn v. M&F Worldwide Corp.*] structure was to create a situation where defendants could effectively structure a transaction so that they could obtain a pleading-stage dismissal against breach of fiduciary duty claims". In order to survive a motion to dismiss under the *Kahn v. M&F Worldwide Corp.* framework, he observed, a plaintiff "would have the burden [of] … pleading facts that would undermine each of its elements". Separately, Vice Chancellor Laster noted that whether a company is private or public should have no bearing on whether the *Kahn v. M&F Worldwide Corp.* framework applies.

Although only a transcript ruling, *Swomley v. Schlecht* has significance as one of the first decisions to apply *Kahn v. M&F Worldwide Corp.*, and will likely further encourage use of the *Kahn v. M&F Worldwide Corp.* framework in squeeze-out transactions where feasible.

Swomley v. Schlecht, C.A. No. 9355-VCL (Del. Ch. Aug. 27, 2014)

Exculpation Determined After Entire Fairness

Under Section 102(b)(7) of the Delaware General Corporation Law, a company may adopt a bylaw provision exculpating breaches of a director's duty of care. Many do. Such exculpation provisions often aid in winning dismissal of claims and cases that involve challenges to a board's decision-making process in connection with a transaction. Arguments under Section 102(b)(7) have long been used by defendants in cases under the business judgment rule. A recent Chancery Court case, *In re Cornerstone Therapeutics Inc. Stockholder Litigation*, will offer the Delaware Supreme Court an opportunity to discuss the application of Section 102(b)(7) to transactions involving a controlling stockholder that are subject to the stringent review of the "entire fairness" standard.

In a memorandum opinion dated September 9, 2014, Vice Chancellor Glasscock held that a determination of whether a director defendant is exculpated from paying monetary damages for breach of the duty of care can be made only after the question of entire fairness is resolved at trial. In other words, an exculpation provision cannot be used to defeat a claim at the motion to dismiss stage, even where a director is otherwise disinterested and independent.

The transaction at issue involved a sale process where a 65% controlling stockholder sought to acquire the remaining outstanding equity interests in a company. A special committee was formed, but approval of the transaction was not made contingent on the approval of a majority of the minority stockholders, making review under the business judgment rule (per *Kahn v. M&F Worldwide Corp.*, discussed above) unavailable. The transaction was eventually approved by more than 80% of minority stockholders, but the court held that a decision as to director exculpation cannot be made until after the question of entire fairness is resolved at trial.

On September 26, 2014, the defendant directors moved for leave to appeal the decision, which was granted by the Delaware Court of Chancery and certified to the Supreme Court of the State of Delaware for further disposition. The court's decision will likely provide further guidance. In the interim, the risk of full entire fairness review prior to the availability of exculpation will likely further encourage the use of the protective framework for controlling stockholder transactions that was set out in *Kahn v. M&F Worldwide Corp.*

In re Cornerstone Therapeutics Inc. Stockholder Litigation, C.A. No. 8922-VCG (Del Ch. Sept. 9, 2014)

Court of Chancery Confirms Corporations Do Not Owe Fiduciary Duties to Stockholders and Cannot Aid and Abet a Fiduciary Breach

On August 7, 2014, in *Buttonwood Tree Value Partners, L.P. v. R.L. Polk & Co., Inc.*, the Delaware Court of Chancery dismissed stockholder claims against a Delaware corporation on the grounds that a corporation itself (as distinct from its directors and officers) owes no fiduciary duties to its stockholders, and that the corporation itself cannot aid and abet a fiduciary breach by its own directors and management.

The plaintiffs, Buttonwood Tree Value Partners, L.P. and Mitchell Partners, L.P., were stockholders in the defendant corporation, R.L. Polk & Co. ("R.L. Polk"), an auto parts manufacturer that was largely owned and operated by the Polk family. In 2011, R.L. Polk offered to purchase a limited number of its outstanding shares for $810 per share through a self-tender. R.L. Polk made certain representations to stockholders in connection with the self-tender, including that there were no plans for a merger transaction or for a material change to its indebtedness. Buttonwood Tree Value Partners, L.P., tendered its shares in connection with the self-tender for $810 per share, and Mitchell Partners, L.P., sold its shares for $811 per share to a third party before the close of the self-tender.

The next year, in 2012, R.L. Polk began exploring strategic alternatives, and in June 2013 the company announced that it had agreed to merge with HIS, Inc., for over $1.34 billion, or $2,675 per share. The plaintiffs sued R.L. Polk & Co., alleging that the company itself, through its directors and officers, deliberately undervalued the company at the time of the self-tender in order to benefit themselves in the subsequent merger transaction, and failed to disclose facts that would have alerted tendering stockholders to that under-valuation.

R.L. Polk moved to dismiss the complaint for failure to state a claim, and the Delaware Court of Chancery granted the motion. The court made clear that "a corporation does not owe fiduciary duties to its stockholders," and so cannot be sued for breach of those duties. The court did, however, distinguish fiduciary duties from other duties that a company might owe to its stockholders, including duties to disclose information (such as might be imposed, for example, by federal securities law). The court left open the possibility that plaintiffs could proceed against the company on a fraud theory.

The court further held that "a corporation cannot aid and abet violations by the fiduciaries who serve it" because "a corporation acts through its directors."

Buttonwood Tree Value Partners, L.P. v. R.L. Polk & Co., Inc., C.A. No. 9250-VCG (Del. Ch. Aug. 7, 2014) (Glasscock, V.C.)).

Court of Chancery Holds Failure to Include Management Presentations in Proxy Statement Not a Breach of the Duty of Candor

In *Dent v. Ramtron*, Vice Chancellor Parsons dismissed a claim that a target company's board breached its duty of candor by failing to disclose to stockholders internal management projections that the target company's financial advisor relied upon in valuing the company. The case follows in a long line from the Court of Chancery's 2007 decision in *In Re Netsmart Technologies, Inc. Shareholders Litigation*, which focused plaintiffs' attention on management projections in making claims of inadequate disclosures. *Dent* further shows that claims seeking disclosure of certain projections will require Plaintiffs to allege, in a fact-intensive way, why the particular information sought is important to a stockholder's decision-making process and would alter the overall mix of available information.

Ramtron International Corporation ("Ramtron") received an unsolicited offer from Cypress Semiconductor Corporation ("Cypress") in the spring of 2011 to purchase Ramtron for $3.01 per share (a 27% premium at the time). The board rebuffed Cypress' initial offer as inadequate, and no further advances were made by Cypress for over a year. Cypress showed renewed interest in the summer of 2012, offering to buy Ramtron for a reduced price, and threatening to conduct a hostile acquisition if the two companies failed to agree to terms. Ramtron eventually agreed to a sale at $3.10 per share. With support from the Ramtron board of directors, Cypress acquired 78% of Ramtron's shares via tender offer. Unable to complete the transaction via short-form merger, Cypress proceeded with a long-form merger and scheduled a stockholder vote to approve the transaction.

The definitive proxy statement contained a summary of four financial analyses performed by Needham & Company, including a discounted cash flow ("DCF") analysis, which was prepared based on management's projections. Although the projections were relied upon by Needham in preparing its DCF analysis, they were not disclosed in the proxy. Ramtron stockholders approved the merger in November of 2012.

The court first noted that there is no *per se* duty under Delaware law to disclose management projections relied upon by financial advisors in preparing their analysis because the question of materiality is context-specific.

The court also distinguished the case from *Netsmart*. Unlike that case, the Ramtron stockholders did not have to weigh the costs and benefits of selling their shares versus maintaining their holdings in a going concern. Cypress had already acquired a majority of interest in Ramtron, guaranteeing a vote approving the merger. The only real decision before the stockholders was whether to accept the merger consideration or seek appraisal.

The court focused on plaintiffs' failure to plead how disclosure of management's projections would significantly alter the total mix of information available to Ramtron's stockholders. The proxy statement disclosed Needham's DCF analysis as well as the fact that such analysis was based on Ramtron management's projections. A reasonable stockholder could have determined from the information disclosed in the proxy statement that the transaction consideration paid by Cypress was lower than Ramtron's estimate of its future earning potential.

Dent v. Ramtron, C.A. No. 7950 VCP (Del. Ch. June 30, 2014).

Bylaws Need Not Select Delaware as Forum

On September 8, 2014, in *City of Providence v. First Citizen Bancshares, Inc.*, the Delaware Court of Chancery held that a forum selection bylaw selecting the courts of North Carolina as a forum was facially valid as a matter of law. Writing for the court, Chancellor Andre Bouchard noted that the forum selection bylaw at issue was virtually identical to the ones the court found to be facially valid by then-Chancellor Strine in *Boilermakers Local 154 Retirement Fund v. Chevron Corporation* except that it selected a forum other than Delaware. Applying the reasoning of *Chevron*, Chancellor Bouchard noted that forum selection bylaws are "statutorily and contractually valid under Delaware law," with no requirement that a Delaware corporation select Delaware as a forum. First Citizens had selected North Carolina because the bank has its headquarters there. This decision appears to broaden the options for boards considering forum-selection bylaws, particularly where a company would prefer to litigate internal corporate matters in the courts of the state where it is headquartered, but subject to Delaware law.

City of Providence et al v. First Citizens Bancshares, Inc. et al, C.A. No. 9795-CB (Del Ch. Sept. 8, 2014).

Oregon Court Refuses to Enforce Delaware Exclusive Forum Selection Bylaw

A recent decision in Oregon, however, demonstrates the risk that non-Delaware jurisdictions may decline to enforce a Delaware forum selection bylaw, in particular where that bylaw was adopted after the stockholder plaintiff filed suit or under other circumstances that may be viewed by a court (rightly or wrongly) as an attempt to "insulate" a board from litigation related to a transaction. The case, *Roberts v. TriQuint Semiconductor, Inc.*, was brought in Oregon Circuit Court, challenging a merger between TriQuint Semiconductor, Inc. ("TriQuint") and RF Micro Devices, Inc. ("RFMD"). Defendants filed a motion to dismiss, which was denied, seeking to enforce a Delaware forum selection bylaw adopted at the same time the board approved the merger.

On February 24, 2014, TriQuint and RFMD announced that they had entered into a merger of equals. At the meeting at which the TriQuint board of directors approved the merger, the board also adopted a Delaware exclusive forum selection bylaw. Notwithstanding that bylaw, certain stockholder plaintiffs filed suit in Oregon, where TriQuint is headquartered, to enjoin the transaction. Other stockholder plaintiffs filed a parallel Delaware action. Confronting multi-jurisdictional deal litigation, TriQuint moved to dismiss the Oregon action based on its forum selection bylaw.

An Oregon state circuit court rejected TriQuint's motion to dismiss and refused to enforce TriQuint's exclusive forum selection bylaw. In so doing, the court relied heavily on the 2011 *Galaviz v. Berg* decision from the United States District Court for the Northern District of California. *Galaviz* invalidated a Delaware exclusive forum selection bylaw implemented by Oracle after certain stockholder plaintiffs filed a derivative action, holding that contract principles precluded enforcement because the bylaw was enacted after the alleged wrongdoing occurred and was enacted unilaterally by directors who were defendants in the derivative action. The Oregon court's decision to follow *Galaviz* is at odds with other decisions from California, Illinois, Louisiana, and New York, in which courts declined to follow *Galaviz* and elected to enforce Delaware exclusive forum selection bylaws.

Distinguishing Chancellor Strine's opinion, the *TriQuint* court characterized the *Chevron* opinion as a "narrow holding," and instead relied heavily on the 1971 Delaware Supreme Court decision in *Schnell v. Chris-Craft Industries, Inc.* There, the court rejected an attempt by the Chris-Craft board to respond to a proxy contest by amending its bylaws to accelerate the date of the corporation's annual meeting and move the meeting to a remote town, which the court held was a deliberate attempt to obstruct legitimate stockholder rights. The *TriQuint* court held that, because the TriQuint board had adopted the forum selection bylaw at the same meeting in which it approved the merger, it had attempted to insulate itself from litigation and had foreclosed any stockholder attempt to repeal the new bylaw. The Oregon court did not address the fact that the TriQuint forum selection bylaw did not preclude stockholder litigation relating to the merger (indeed, identical stockholder litigation was filed in Delaware).

Ultimately, the *TriQuint* court acknowledged that exclusive forum selection bylaws can be enforceable, but only if they are adopted prior to the alleged wrongdoing and "with ample time for the shareholders to accept or reject" the bylaw. In focusing on those criteria, the court placed particular emphasis on whether the shareholders would be "forced to accept" the bylaw—an analysis not emphasized by more recent rulings from other courts evaluating the enforceability of a Delaware exclusive forum selection bylaw. While the *TriQuint* ruling counsels in favor of enacting a forum selection bylaw "on a clear day", it should be noted that the opinion deviates from the weight of current precedent on this issue by imposing this additional requirement.

Roberts v. TriQuint Semiconductor, Inc., Case No. 1402-02441 (Oregon Cir. Ct., Aug. 14, 2014).

Chancery Court Highlights Need for Clarity in Priority of Sources of Advancement and Indemnification

The Delaware Court of Chancery's recent decision in *Pontone v. Milso Industries Corp*., C.A. No. 8842-VCP (Del. Ch. Aug. 22, 2014), is the latest in a line of cases considering advancement and indemnification rights. This case in particular highlights how crucial the wording of advancement and indemnification provisions can be to a director's ability to pursue his or her rights in the midst of litigation. The decision also highlights the need for directors, companies, and sponsors to consider carefully the contractual terms that govern alternative sources of indemnification.

The *Pontone* case falls in a line of cases that began with *Levy v. HLI Operating Co.*,[1] in which the Delaware Court of Chancery held that an indemnified director who had been fully reimbursed for litigation and settlement expenses by one indemnitor lacked standing to pursue indemnification from another indemnitor, because the director could not show financial loss. In that case, the director was the designee of the company's private equity sponsor, and the private equity fund's limited partnership agreement provided for mandatory advancement and indemnification. The fund had paid his expenses after the portfolio company refused. Soon after *Levy* was decided, in *Schoon v. Troy Corp.*,[2] the Court declined to extend *Levy*'s reasoning to circumstances where a shareholder voluntarily undertakes to advance defense expenses for the benefit of its board designee, where the designee was obligated to repay such amounts to the shareholder. The *Schoon* Court held that a party receiving voluntary advancement from one source had standing to pursue mandatory advancement from another source.

In *Pontone v. Milso Industries Corp.*, the court considered whether, under both 8 *Del. C*. ¶ 145 and the applicable agreements among the parties, a former officer and director of two Delaware companies had standing to assert a claim for advancement for legal fees and expenses he incurred in litigation against those companies, where the director also had another source of potential advancement, and had already received advancement from that source for fees incurred. Vice Chancellor Parsons held that (1) a director has standing to assert a claim for advancement as to expenses, both incurred but unpaid and not yet incurred, for which he has not yet received advancement from another source that is obligated to advance; (2) a director does not have standing to assert an advancement claim against the companies as to expenses for which the director has already received payment of advancement from the other source (but that other source may be able to pursue contribution from its co-indemnitors, the companies); and (3) a director may obtain a prorated portion of "fees on fees," as well as prejudgment interest, for his attempts to prosecute an advancement claim, notwithstanding the fact that he has not been 100 percent successful in prosecuting his claims.

[1] 924 A.2d 210, 214 (Del. Ch. 2007).
[2] 948 A.2d 1157, 1159 (Del. Ch. 2008).

The court reasoned that the fact that plaintiff had requested and received advancement from another source in the past did not preclude or undermine plaintiff's independent contractual right to advancement under the bylaws of York and New Milso. In addition, the Court noted that York and New Milso could have contracted around this issue by stating in their bylaws that they would provide advancement only to the extent that covered individuals are unable to obtain advancement from other sources, but did not do so.

The *Pontone* case highlights the need for indemnitors and indemnitees to be mindful of the importance of addressing at the outset any issues relating to multiple sources for advancement or indemnification. In particular, indemnitors cannot use *Levy*'s standing requirements to shirk advancement liability for incurred but unpaid and for future expenses that are subject to advancement. That is, there is no incentive to dodge advancement obligations in the hope that they can be avoided when another party meets its obligation. Recalcitrant parties who owe advancement also risk "fees on fees" awards.

As for indemnitees, Pontone stresses the importance of bringing contribution actions early, thereby reducing the amount at issue in any contribution action. It is also important to attempt to contract around potential advancement and indemnification problems, e.g., a loan forgiveness provision that only provides for partial release, to the extent of the lending party's co-indemnity obligation.

Pontone v. Milso Industries Corp., C.A. No. 8842-VCP (Del. Ch. Aug. 22, 2014).

<u>*Rural Metro* Damages Decision Results in Significant Liability for Financial Advisor</u>

The *Ropes Recap* for the First Quarter of 2014 reported on the Delaware Court of Chancery's March 7 post-trial liability opinion in *In Re Rural Metro Corporation Stockholders Litigation*. In that decision, Vice Chancellor Travis Laster held Rural/Metro's financial advisor, RBC, liable for aiding and abetting the Rural/Metro board of directors' breach of its fiduciary duties in connection with the acquisition of Rural/Metro by Warburg Pincus. The Vice Chancellor found that, among other things, RBC advised the board not to expand and extend the sales process in ways that would likely have generated greater bids and provided a tardy and insufficiently robust valuation analysis that was engineered to justify the deal price. He also rejected RBC's argument that a general conflict waiver in its engagement letter was sufficient to preclude aiding-and-abetting claims, because RBC failed to disclose specific conflicts related to the deal, in particular its goal of providing "stapled financing" to the ultimate acquirer.

On October 10, the Vice Chancellor Laster issued his opinion on damages, holding RBC liable for 83% of the damages suffered by the class, or $75.8 million dollars. The damages decision serves as a reminder that aiding and abetting a breach of fiduciary duty remains a viable claim Delaware, highlighting the importance of a well-run sales process. The decision also demonstrates the Delaware Court of Chancery's continued willingness to hold financial advisors liable in situations where such advisors succumb to conflicts created by "stapled financing," particularly where there is no specific disclosure of such conflicts either in an engagement letter or elsewhere. In addition, the decision shows how exculpation clauses for breaches by directors of the duty of care (as permitted by Section 102(b)(7) of the Delaware General Corporation Law), can serve to shift liability to non-settling defendants, and force them to take awkward positions against their clients at trial.

The liability-shifting effect of the *Rural/Metro* damages decision is grounded on its treatment of an issue of first impression in Delaware: the allocation of liability between corporate fiduciaries and their advisors under Delaware's Uniform Contribution Among Tortfeasors Act ("DUCATA"), 10 *Del C.* § 6301, *et seq*. In aiding and abetting claims, all tortfeasors are jointly and severally liable, though a plaintiff may recover from any one of the tortfeasors. The court therefore had to decide whether RBC, as the only party that did not settle pre-trial, would be entitled to claim "credit" for the consideration paid by the settling parties. Vice Chancellor Laster concluded that, because DUCATA does not bar contribution for intentional torts, RBC could attempt to claim credit under DUCATA.

To receive "settlement credit," RBC had the burden of establishing that the settling defendants were joint tortfeasors—that is, that they were liable as well. The Court noted that the settlements did not include admissions of liability, and that RBC had the opportunity to develop a record to support its contribution claims at trial (by presenting evidence of wrongdoing by the directors, rather than by RBC). But RBS opted not to do so, instead presenting a "united front" defense. Thus, to determine whether directors were liable as joint tortfeasors, the Court looked to whether the director defendants would have been entitled to exculpation under Section 102(b)(7). If so, then RBC could not obtain contribution from them, and therefore could not claim "settlement credit." RBC had the burden of proving that exculpation was not available because the factual basis for the underlying claims did not solely implicate violations of the duty of care. The court concluded that two of the directors were not entitled to exculpation, including the director who led the Special Committee in hiring RBC as the Company's banker. Those two directors were allocated 17% of total liability.

To assess damages against RBC, the Court conducted a quasi-appraisal and concluded the Class suffered damages of $4.17 per share, or $91.32 million in aggregate. That amount was offset by the 17% attributable to the directors who settled but who were not entitled to exculpation, leaving RBC responsible for $75.8 million in damages. This "liability-shifting" from exculpated directors to RBC suggest that RBC might have kept its liability lower by pointing fingers at the settling directors, rather than by maintaining a "united front" defense. This obviously would have put RBC in the awkward position of, in effect, blaming its client to protect itself.

In re Rural/Metro Stockholders Litigation, C.A. No. 6350–VCL (Del. Ch. Oct. 10, 2014)

Federal Update

New Bill Aims to Expand CFIUS Review Process

An outspoken critic of last year's acquisition of Smithfield Foods, Inc., by China's Shuanghui International, Congresswoman Rosa L. DeLauro (D-CT) recently introduced a bill that, if passed, would substantially expand both the substance and the scope of the Committee on Foreign Investment in the United States (CFIUS) review process. CFIUS presently reviews the national security implications of acquisitions of certain U.S. business by foreign parties.

Introduced on September 18, 2014, the bill, known as the "Foreign Investment and Economic Security Act of 2014" (HR 5581) ("FIESA"), would require CFIUS to determine not simply whether a covered transaction is a threat to national security interests, but whether the transaction would present a "net benefit" to the U.S. FIESA prescribes the following factors for making this "net benefit" determination:

(A) The effect on U.S. economic activity (*e.g.*, quality of employment, utilization of parts/services produced in the U.S., exports from the U.S.);

(B) The effect on U.S. technology, productivity, and innovation;

(C) The effect on competition within the relevant U.S. industry;

(D) The transaction's compatibility with national industrial/economic/cultural policies; and

(E) The transaction's effect on public health and safety.

In the case of a foreign government or state-owned entity acquiring a U.S. company, FIESA proposes adding additional factors aimed at testing the "commercial orientation" of the foreign acquirer as well as the foreign acquirer's stated governance policies and extent of its adherence to U.S. standards of economic and accounting transparency.

In a statement made after introducing the bill, Congresswoman DeLauro stated that her CFIUS amendment is "necessary to ensuring American workers are not sacrificed for foreign profits," and DeLauro would accordingly elevate the Secretary of Labor to the ranks of CFIUS members with a vote on the net benefit determination, joining the Attorney General, the U.S. Trade Representative, Secretary of Commerce, and the Secretary of the Treasury. (The Secretary of Labor currently is a non-voting member of CFIUS.) Also receiving a vote would be the Department of Agriculture for transactions that may affect the agricultural sector and the Department of Health and Human Services for transactions that may affect the public health.

FIESA would also expand the types of transactions subject to CFIUS review. Not only would CFIUS be charged with reviewing mergers, acquisitions or takeovers by a foreign person that result in control of covered U.S. businesses, but also "any construction of a new facility in the United States by a foreign person."

While it is unlikely Congress will take any action on the bill this year, it proposes one potential avenue for revamping CFIUS in light of criticisms spotlighted last year during the course of the Smithfield transaction.

Cornerstone Report on Securities Litigation in H1 2014:
Report Shows Decline in Securities Class Action Litigation

In August 2014, Cornerstone Research issued its mid-year assessment of securities class action filings. Cornerstone reported that plaintiffs filed 78 securities cases in the first six months of 2014–fewer than the 91 that were filed in the second half of 2013, and nearly 20% below the historical semiannual average since 1997.

Analysis of securities filings' impact on market capitalization showed an even more pronounced decline. Cornerstone's disclosure dollar loss metric, which measures the change in value of a defendant firm's market capitalization between the trading days immediately preceding and immediately following the end of the class period, totaled $30 billion for cases filed during the first half of 2014, less than half of the historical average since 1997 ($62 billion). Similarly, for cases filed during the first half of 2014, the decline from defendant firms' highest market capitalizations during the class period to their valuation on the day immediately following the class period (the maximum dollar loss) totaled $93 billion. This is materially less than the average of $315 billion per six-month period from 1997 through 2013. One of the drivers of the decline in dollar losses associated with the securities filings during H1 2014 was the fact that there were no "mega claims" filed during the period (i.e., filings with an alleged loss of at least $5 billion or a decline in market capitalization of at least $10 billion from the class period peak to the day immediately following the class period).

Despite this decline in mega securities litigations filings, Cornerstone found that the likelihood that a public company will be the subject of a filing has remained near historical averages; approximately one in 60 companies listed on the major U.S. exchanges was the subject of a class action during the first half of the year. Additionally, securities cases continue to be filed shortly after the end of the class period/issuance of the alleged corrective disclosure, with an average lag of 12 days, and companies in the healthcare, biotechnology, and pharmaceutical industries were the most frequent targets for shareholder class actions.

New Regulations Likely to Slow "Inversion" Deal Activity

Over the past several years, the frequency and notoriety of so-called "inversion" transactions has increased dramatically. An inversion typically involves a U.S. company merging with an overseas company, with the U.S. company becoming a wholly-owned subsidiary of the non-U.S. parent. Many companies have used the "inversion" structure over the past few years, with notable deals including Argonaut-PXRE (reincorporating in Bermuda), Alkermes-Elan Drug (reincorporating in Ireland), and Liberty Global-Virgin Media (reincorporating in the United Kingdom).

The proliferation of this structure reflects an oddity of U.S. tax law: unlike most developed nations' corporate tax systems, U.S. taxes on corporate profits are not limited to U.S.-based earnings, but also include earnings abroad that are repatriated. This not only makes effective corporate rates much higher for U.S.-based companies, but also prevents many U.S.-based companies from bringing foreign earnings into the U.S., thereby reducing the potential for investment and shareholder returns. As a result, U.S. companies that reincorporate abroad often choose to do so in a country with a corporate tax rate that is lower than the U.S. rate, one with a territorial tax system (i.e., one that does not tax income from a foreign source), and one that has entered into an income tax treaty with the United States. The economic advantage is undeniable: reincorporating in Bermuda generally yields a corporate tax of 0%, in Ireland approximately 12.5%, and in the United Kingdom approximately 21%. These rates represent a significant reduction from the 35% marginal federal corporate tax rate many companies face in the United States.

Although such deals are designed specifically to conform to U.S. tax laws and regulations, "inversions" have come under increasing attack by politicians and the press, who typically deride the deals as "unpatriotic" attempts to shirk taxes. After months of rhetorical attack on inversions by the Obama administration, the Department of the Treasury and the Internal Revenue Service issued a notice of new regulations on September 22, 2014, "to reduce the tax benefits of—and when possible, stop—corporate tax inversions." Critics have noted that these rules were issued within months of statements by administration officials that, absent additional legislation, they lacked the power to limit inversions by regulation. Regardless, the rules have led to the termination of at least one deal, the $54 billion merger of Shire and AbbVie.

The new Treasury and IRS rules are designed to limit key advantages of inversions in four specific ways: prevention of "hopscotch" loans; tightened restrictions on inverted companies' tax-free access to a foreign subsidiary's earnings; disallowance of tax-free cash and property transfer between a foreign subsidiary and its new parent; and stronger requirements that the former owners of the inverted company own less than 80% of the new combined entity.

- "Hopscotch" loans allow inverted companies tax efficient access to a foreign subsidiary's earnings (i.e., the cash trapped offshore). However, the new regulations prevent this tax treatment by considering loans of inverted companies as dividends that are taxable in the United States. The new tax treatment is the same as if the foreign subsidiary had made a loan to the inverted company before the inversion took place.
- Previously, inverted companies could restructure a foreign subsidiary in a way that allowed the inverted company tax-free access to the subsidiary's earnings. However, the new regulations restrict post-inversion transfers of a U.S. target's controlled foreign corporation shares as well as those corporation's assets. This rule change will make it more difficult to access overseas cash tax-free.

- Treasury notes that the new regulations will expand the reach of current IRS rules to prevent inverted companies from transferring cash or property tax-free from a controlled foreign corporation to the new parent. This change means inverted companies will no longer be able to repatriate cash or property tax-free by bypassing the U.S. inverted company.
- The new rules also tighten the restriction that the former owners of the inverted company own less than 80% of the new combined entity, making it more difficult for a U.S. company to invert. Passive assets, including cash or marketable securities, that were not part of the foreign entity's daily business functions previously counted towards this 80%; however, the new regulations disregard much of these assets from the calculation. The new rules also prevent U.S. companies from reducing their pre-inversion size by making extraordinary dividends to meet the 80% threshold.

Notably, the new regulations did not address transfer pricing or earnings stripping, other practices which can reduce the amount of taxes owed by U.S. companies.

The new regulations will likely draw a challenge in the courts. But until their fate is decided, we expect the new regulations to reverse the upward trend in corporate inversions in recent years.

Notable Deals

Dollar General Rebuffed (Again), But the Fight Goes On

Dollar General Corporation has now been rejected twice in its takeover bid for rival Family Dollar Stores, Inc. This saga began in June 2014 when Dollar General and Family Dollar discussed a possible deal. By the end of July, however, the tide had turned, and Dollar Tree, Inc., stepped in, agreeing to buy Family Dollar for approximately $8.5 billion in a combined cash-and-stock deal. Dollar General, spurred on by the competition, offered to buy Family Dollar for approximately $9 billion in an all-cash deal.

Realizing the merger could face antitrust complications from federal regulators, along with its bid, Dollar General offered to divest up to 700 of its stores if needed. On August 21, 2014, just three days after Dollar General's first bid, the Family Dollar board of directors unanimously rejected Dollar General's unsolicited offer, specifically citing antitrust concerns. On September 2, 2014, Dollar General increased its bid to approximately $9.1 billion and offered to divest up to 1,500 stores if antitrust difficulties required it to do so. With this second offer, Dollar General also included a $500 million reverse termination fee if the deal is stymied by regulators. Family Dollar's board of directors also rejected Dollar General's second bid. Twice-spurned, Dollar General then took its offer directly to stockholders, commencing a hostile tender offer for Family Dollar's outstanding stock on September 10, 2014. The tender offer was set to expire on October 10, 2014, but was extended to October 31.

The Family Dollar board of directors has advised stockholders not to tender their shares, and interestingly, large Family Dollar stockholder and activist hedge fund Trian Partners has followed the board's recommendation in refusing to tender, even though Dollar General is offering a higher price than Dollar Tree. Family Dollar, continuing to stand firm in its rejection of the Dollar General offer, declared in a joint press release with Dollar Tree that it expects a deal with Dollar Tree to close as early as November 2014.

London Update

The Small Business, Enterprise and Employment Bill Would Increase the Ability to Identify Those Who Own and Control UK-Registered Companies

The Small Business, Enterprise and Employment Bill, which would amend the Companies Act 2006, was recently introduced into the UK Parliament. The Bill proposes a number of company law reforms that are intended to make it easier to establish the identity of the individuals who own and control companies that are registered in the United Kingdom. If enacted, these changes would represent a paradigm shift for private and unlisted public companies. Persons holding or interested in purchasing significant control in a UK-registered company will need to be aware that such ownership will be a matter of public record, if the Bill is enacted.

The proposed reforms implement a number of the commitments that the UK Government made as part of the G8 summit in June 2013, that are designed to promote trust in the way in which companies are run and business is conducted in the United Kingdom. The aim is to limit the scope for companies to be used for illicit activities and for those who own and run them to avoid detection. The Government presently intends to bring the legislation into force before the end of its current term, but the Bill still has a number of hurdles to pass before it becomes law, and may be modified during this process.

The centerpiece of the company law reforms proposed by the Bill is the requirement for all companies to maintain a register of individuals who have "significant control" over the company, which will be available for the public to review. Under the proposed new regime, all companies that are registered in the United Kingdom (other than those that are already subject to public disclosure regimes) would be required to maintain a new statutory register (the "PCS Register") of individuals who have 'significant control' over the company. This goes far beyond the current statutory requirement for all companies to maintain a statutory register of their registered members.

In broad terms, the test for "significant control," as currently proposed, looks to (i) ownership or control of 25% of the shares and/or voting rights of the company; (ii) the right to appoint and remove a majority of the board; and/or (iii) other circumstances where an individual has the right to exercise or actually exercises 'significant influence or control' over the company. These provisions will operate on a look-through basis, and will capture indirect interests. Companies will be obliged to take the necessary steps to gather the requisite information about these individuals in order to populate its PSC Register. Those individuals who have significant control will be under a complementary obligation to disclose their status to the company. Sanctions will apply to companies, their directors and relevant individuals who fail to comply with their obligations.

The primary administrative burden of identifying individuals who have significant control will fall squarely on the company. Companies will be given the requisite tools to require any person whom the company believes to have an interest in shares to declare such an interest. However, it is not yet clear how far companies (and their directors) will be expected to go in terms of carrying out any broader, more forensic review into the beneficial ownership of the company's shares in order to discharge their new statutory duty.

Conversely, individuals who acquire significant control of a company registered in the United Kingdom will need to understand that their interest in the company in question will be a matter of public record. In order to ensure that they comply with the regime, investors will first need to identify whether their interest in a company constitutes "significant control." If so, investors will then need to ensure that they have taken the necessary steps to disclose this interest to the company, which might involve responding to information requests from the company or proactively disclosing their interest, if the company has failed to identify it.

Certain commentators have questioned whether the objective of greater transparency could be achieved by maintaining the register privately. This would provide law enforcement authorities with the necessary information to act expediently against those who misuse companies for illicit purposes, but would not compromise the anonymity of individuals who wish to keep their business activities confidential. This said, these reforms are part of a broader trend towards greater transparency in the United Kingdom, following such recent examples as the Alternative Investment Fund Managers Directive and the Financial Services Act 2012. In any event, it is difficult at this stage to predict what real impact the proposed change would have in practice above and beyond the administrative practicalities mentioned above. It also remains to be seen whether the Bill will encounter any resistance in Parliament.

Asia Update

Administrative Controls Relaxed for Outbound Investments by Chinese Enterprises

On September 6, 2014, the Ministry of Commerce of the People's Republic of China ("MOFCOM") issued a revised version of the Administrative Measures for Outbound Investment, which took effect as of October 6, 2014 (MOFCOM Order 2014 No. 3) ("New Measures"), amending the Administrative Measures for Outbound Investment issued by MOFCOM in 2009 (MOFCOM Order 2009 No. 5) ("Old Measures"). The New Measures aim to facilitate Chinese enterprises' outbound investments, furthering the Chinese government's efforts to reduce administrative approval through simplified procedures.

The New Measures repeal the requirement under the Old Measures that enterprises obtain approval of MOFCOM or its provincial counterparts before their outbound investment agreements become effective. A new administrative system of "filing in principle and approval as a supplement" is established under the New Measures to replace the approval regime under the Old Measures. Only outbound investments involving "sensitive" countries or regions and sensitive industries (as set forth in the New Measures) require approval. Such "sensitive" countries or regions include those that have not established diplomatic relationships with the People's Republic of China or are under United Nations' sanctions. Outbound investments in financial institutions are governed separately and not covered by the New Measures.

Under the New Measures, the application materials required for filing or approval are simplified and the time limits for MOFCOM's decision-making on applications are shortened. For example, for outbound investments subject to filing, the applying enterprise may successfully complete a filing in three business days after submitting a filing form and a photocopy of its business license.

Prohibitions on certain outbound investments remain in the New Measures, including investments regarded as (i) "endangering" the state sovereignty, national security and the public interests of China or violating any Chinese law or regulation, (ii) damaging to the relationship between China and the relevant country/region, (iii) violating any international treaty to which China is a party, or (iv) involving any technology or goods that are prohibited from export.

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